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THE MOBILIZATION OF YOUTH IN MARXIST EAST GERMANY

By Stephen Bowers

East Germany stands as a monument to the decision taken by the Western allies towards the end of World War II to place east and central Germany under Soviet control. Thirty-five years later, the people of the German Democratic Republic are still widely regarded as living under one of the most repressive governments in Eastern Europe. This condition received further publicity when in late 1975 East-West German relations were once again shaken by a controversy over the forced adoption of children for purposes of political re-education.

The dispute to which we refer began with western reports of three cases in which the children of would-be refugees from the German Democratic Republic were taken from the jurisdiction of their imprisoned parents and forcefully given to foster parents for permanent adoption. The imprisoned parents were not even allowed to know the identity or location of those who had been given control over their children, and were never to be allowed to see their children again, even after the expiry of their sentences. Related East German practices, involving the allocation of children from broken marriages to the homes of loyal party members for "educational reasons," were also publicized, as also details concerning the GDR divorce laws which grant custody of children not in accordance with the wishes of either parent or of the children themselves, but on the basis of which marriage partner has the "better" political background.(1)

Although some sought to dismiss such practices as isolated departures from what Westerners would consider reasonable procedures for any modern state, an examination of the GDR's youth policy illustrates the very logical role of such policies as part of an intensive effort to mold East German youth in the image of a "new socialist personality" described in the policies and publications of the Socialist Unity Party of Germany (SED). Once the SED's effort is understood, "forced adoption" can be recognized, not as a bureaucratic aberration, but as evidence of determination of the GDR authorities to shape East German

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society in accordance with the current interpretation of Marxist-Leninist doctrine. Such a recognition does not diminish the essential cruelty of this practice but it does facilitate an understanding of its place in this very important aspect of East German policy.

The Development of Personal Commitment

Every society requires a system of instruments to assure social and political control as well as the endurance of the regime. Support may be built by reliance upon one or all of three types of powers at the disposal of authority. Typical usage defines these as, first, normative power persuasion, second, material power such as salaries and rewards, and, third, coercive power, restrictive or repressive measures ranging from fines to physical violence.

Building on this concept and considering the capabilities of each type of power, Alexander Dallin and George W. Breslauer have argued that communist party states should be regarded as "developing policies" inclined to alter their reliance upon certain powers as they progress through various developmental stages.(2) Their developmental hypothesis posits the existence of three successive stages — takeover, mobilization, and post-mobilization — requiring progressively less use of coercion. The takeover stage, that period immediately following the seizure of power, is characterized by open warfare against both foreign and domestic foes as the new regime consolidates power. During the mobilization stage, the revolutionary regime attempts decisive breakthroughs toward goals designated as vital to the new system. The Bolshevik campaign for forced collectivization of agriculture initiated in 1928 is a classic example and demonstrates the extensive use of political terror against rival authority figures and incongruent value structures. The final period, the post-mobilization stage, witnesses a dramatic change in the process of generating system support. During this era "calculable forms of coercion may be substituted for arbitrary forms," there is a "shift in the balance among the three alternative sanction systems" with greater reliance on normative/material power, and the total scope of political control decreases. (3)

A basic presupposition of this analysis is that the German Democratic Republic is in the post-mobilization stage and, therefore, inclined toward greater dependence upon normative

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power and more restricted, selective use of coercion in building system support. A system less dependent upon coercion must also concentrate more on provision of material rewards as a means of building support. This commitment involves an effort to match outputs to demands in order to keep system members content. Yet, as Almond and Verba have argued,

> Loyalty to a political system, if it is based on purely pragmatic considerations of the effectiveness of that system, represents . . . a rather unstable basis of loyalty, for it is too closely dependent upon system performance. If it is to remain stable in the long run, the system requires a form of political commitment based upon more general attachment to the political system. (4)

The GDR is seeking to build general support based on a blend of marxism and patriotism. In practice this requires a unique combination of internationalism and nationalism. Accepting the proposition that political orientations and attachments which have significant consequences for adult attitudes and behavior are being transmitted to East German young people during their formative years, this paper considers the use of normative techniques in the GDR as vital to national development. These normative techniques are best illustrated by the SED's efforts in educational and military training programs.

In the first years after 1945, the period Dallin and Breslaver would call the takeover stage, East German leaders recognized the importance of mobilizing youth in the struggle to create a new order. The regime's objective at this stage seems to have been the development of an ideological commitment to a system still in the process of creation. Few material incentives could be given simply because of the narrow resource base of the nation. Priority was given to effecting major social and economic changes during this period, a basic characteristic of the takeover stage.

The instrument for involving young people in the economic and political life of the GDR is the Free German Youth (FDJ). Founded on March 7, 1946, the FDJ is officially designated as a "reliable helper" of the SED and is included in the National Front. Units of the FDJ are located in factories, schools, state and economic establishments, collective farms, and the military as well as in residential areas. The Central Council, which is the highest organ of the FDJ, is elected by a parliament or national

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congress of the organization which is convened every four years. The parliament is chosen by regional and district delegates conferences which, in theory, represent the basic organizations. Those between the ages of 14 and 25 are eligible for FDJ membership. The junior organization of the FDJ is the Ernst Thaelman Pioneer organization, designed for those between 6 and 14 years old. Closely related to the FDJ is the Society for Sport and Technology (GST), an organization responsible for development of military sports.

Frequency of FDJ membership is viewed by SED leaders as proof of the organization's success in mobilizing young people. In 1974 there were 1,824,000 FDJ members out of a total of 2,890,000 citizens between fourteen and twenty five years old. The fact that two-thirds of the young people have joined the FDJ is described as both clear evidence of the high degree of political organization of youth and a repudiation of "imperialist gossip" about the FDJ as a compulsory organization since one-third of eligible youth are non-members. The Pioneers, by contrast, claim over 96% participation in their age group and might, therefore, be regarded as compulsory.(5)

The SED and Youth in the Post-Mobilization Stage

The SED's desires regarding youth policy were expressed several years ago by First Secretary Honecker who declared that "it will be up to the young generation to reliably continue the revolutionary work" of constructing socialism in the GDR. The development of "socialist personalities," one of two essential characteristics sought by the party, is a necessity for the continuation of such work. Recognizing that the nation's youth offers the party its only chance for realization of its long-term aspirations, the leadership defines the concept of socialist personality as a "party-like standpoint, an internationalist attitude, a sensible adjustment to work, responsible behavior, (and) solid knowledge . . ." (6) Youth characterized by these attitudes and qualities will hopefully work to fulfill the dreams of the leadership for the future.

The second characteristic which the party hopes to stimulate is socialist patriotism. The GDR's *Worterbuch zur Socialistischen Jugendpolitik*, a basic guide to youth policy, defines socialist patriotism as love for the socialist Fatherland and the readiness to give all for its strengthening. (7) Party theorists emphasize

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that each generation approaches socialism in different ways and that such differences must be recognized in formulating methods for inculcating socialist patriotism. Therefore, they suggest that a "wealth and variety of ways and means" be used to approach youth and that youth leaders develop complex guidance programs. Leaders in middle and lower management levels are given a special responsibility since they are closest to the target individuals. (8) The principle arena for this effort is the school and considerable energy is devoted to research on improving their effectiveness in molding attitudes and personalities compatible with ideological and political demands. Ironically, it has been found desirable, or even necessary, to reinforce Marxist ideology (which is essentially internationalist) by appeals to a surviving reservoir of national loyalty of the German youth, while continuing to attack western nations for alleged nationalist, imperialist, and racist policies.

Of a more immediate bearing on the development of youth is legislation such as the 1974 Youth Law which establishes a comprehensive program for the stimulation of youth "to achieve outstanding results for the benefit of socialism." (9) This law begins with a reaffirmation of the need for development of a "socialist personality." This complements a dominant theme in East German literature on the general development of society: the creation of a "new socialist man" exhibiting attitudes and values totally at variance with those of the pre-revolutionary order. The majority of the law's provisions relate to direct and indirect educational functions of schools and factories: promotion of "initiatives" by working youths and students, encouragement of cultural and athletic activities as well as tourism in other East European states, and the "moral obligation" of young people to acquire military training.

The 1974 Youth Law and the numerous other statements on youth policy reveal two broad official concerns. One is the development of "socialist personalities" which reflect a commitment to the cultural and ideological values of the system and the other is the promotion of "socialist patriotism." The principle mechanisms for accomplishment of these objectives are the educational system and the military training program. The military, it is important to note, is more than simply an instrument for national defense, but also an educational force responsible for the emotional as well as physical conditioning

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of East German young people.

Education and the Mobilization of Youth

In the absence of official terror, an authoritarian regime must place much greater emphasis on the role of educational efforts to mold behavior. The statements and policies of the GDR's leadership reflect a recognition of the crucial part played by education in developing personal involvement with the political system and are based on the conception that education is not a process which takes place in a vacuum but rather a class weapon in the struggle with implacable foes. Dr. Guenter Hemling of the GDR Academy of Pedagogical Sciences expressed this view in an article in the monthly youth journal *Junge Generation* in April, 1976. Hemling wrote,

> The education of youth into communist modes of thought and conduct is taking place within the process of constant and increasing confrontation with the ideology of imperialism. (10)

He went on to suggest educational measures designed to develop a "combative political atmosphere" in order to enable youth to meet the imperialist threat.

Efforts to develop a combative political atmosphere are one illustration of the concern for building emotional involvement and are complemented by emphasis on the need for an authoritarian educational environment. East Berlin's SED leader Konrad Neumann, writing in the *Deutsche Lehrerzeitung,* explained the necessity for such an environment, asserting that authority issues are power issues and that "moral and ideological damage and losses" could occur in the absence of strong authority figures in the schools. It is the personality of the teacher, he wrote, that "forms and educates on behalf of the working class," thus performing a vital service since the "formation of the socialist way of life must always be shored up by education." Neumann continues by warning that

> We must keep aware of the consequences of our young people's being confronted with the imperialist way of life, and not only in the form of visitors from the FRG and West Berlin. A lot of moral damage comes from that. But we must not let the people be as they are; we must take them as they should be and educate them.(11)

Thus, it becomes the obligation of the teacher to create the

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proper "moral attitude" by practicing and checking up on modes of conduct.

The Marxist-Leninist concept of freedom is implicit in the SED's view of how an educational institution should be run. East Germany's officials see no conflict between the excessive authoritarianism they desire and the notion of what freedom represents. In discussing the educational work necessary for the well-being of the community, Neumann defined freedom as the ability to do "gladly what is socially necessary." This, he insisted, is part of the "dignity and freedom of man under socialism and communism." (12)

And what is socially necessary under socialism in the GDR? For educators, the most frequent answer is that ideological training is of central importance at this time. Proper ideological training is necessary in developing a commitment to the philosophy supporting the GDR's social and economic institutions. Articles 1 through 7 of the 1974 Youth Law spell out the obligations of educators to aid in the development of "socialist personalities" in young people, something which is not possible in the absence of a firm ideological foundation. "Fulfillment of obligation to educate all students to become highly cultured socialist personalities is the essence of the GDR's communist education. (13) Lothar Oppermann, the chief of the Education Department of the SED Central Committee, has placed a special burden on teachers, demanding that school party organizations intensify their ideological work among teaching staffs. According to Oppermann, teachers are supposed to be able to deal effectively with both domestic and foreign policy issues and must engage in a more offensive confrontation with "enemy ideology." Only the best qualified individuals are capable of satisfying this obligation, so Oppermann calls for a careful examination of teachers' political credentials. Some, he cautions, have too little political commitment and warns that there will be a "party-minded confrontation with those seeking to undermine valid criteria . . ." (14)

Articles 8 through 23 of the Youth Law deal with measures for promotion of youth initiatives, an important educational innovation in SED policy. Article 8 states

> The further organization of an advanced socialist society makes it necessary for working youth to take part, together with all working people, in raising the people's

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standard of living and cultural level. (15)

Article 18 broadens this requirement to cover all young people, including students. A variety of activities are enumerated as part of this effort: participation in socialist competitions, creation of "Young Socialists' Funds" to reward economic initiatives, youth work projects, joining in the "Work, live and learn in a socialist way" program for improving the productive process, placing of young cooperative farmers on executive boards of farms, and competing in the Fair of the Masters of Tomorrow, the GDR's youth innovation project. By the mid 1970's, there were 26,006 FDJ-sponsored youth brigades with 300,195 members active in the GDR. (16) The youth organizations, of course, are very much a part of the educational process.

In recognition of the results of such efforts, East German authorities credit their young people with making a significant contribution to the increased economic power of the nation. Dr. Artur Meier, head of the educational sociology department of the GDR Academy of Pedagogical Sciences, has written that:

> The creative powers of the working people in our country have grown considerably. The young generation, by its diverse initiatives, has had a high share in the great successes. More and more boys and girls regard the main task decided upon by the party as their own personal business and are consciously committed to its realization. (17)

Citing science and technology as the major contributions to the GDR's increased productivity, Meier stresses the importance of the educational process for insuring a continuation of growth in industry and agriculture. The full creative abilities of the nation's youth are needed for both production and politics and will be developed, he insists, only as the personalities of youth are fully developed. Meier explains that this process requires a well-rounded general educational program rather than a narrowly specialized one. Accordingly, authorities seek to maintain a balance between the generalized programs, which include courses in Marxist-Leninist theory, and the specialized programs necessary for creative initiatives. (18) If young people regard the tasks of the party as their own personal business, then a balanced educational program could facilitate a wedding of ideological considerations with technological demands, thus avoiding a situation in which loyalty becomes dependent solely upon system performance.

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A vital element of this balanced program is fulfilled by the East German vocational counseling program. This is a social as well as a personal concern, but it also helps build a functional commitment to the GDR. Authorities claim that the state organs, the schools, and the enterprises have developed coordination enabling them to match student programs with available jobs. Consequently, 99% of all high school graduates receive skilled job training geared toward the demands of employing agencies. (19) Not only does this provide, in the SED's view, a valuable contrast with the situations in capitalist nations, but it does much to provide that most valuable commodity in the GDR, security. In publications, in speeches, and in private conversations, East German authorities stress the importance of security as a goal for GDR society. It's utility is obviously not only social and economic, but also political. Therefore, by providing an effective vocational guidance program supplemented by provisions of the Youth Law which deal with enterprise-school cooperation and apprenticeship programs, the educational system helps the demonstration of effective system performance.

The use of leisure time in the GDR is a special concern for the leadership of East German schools and enterprises. Articles 34 through 38 and Articles 45 through 50 reflect the SED's views on the use of leisure time in building system support. Article 34 declares that it "shall be a concern and task of any young person to engage in regular sports activities to develop his personality." (20) East German literature is replete with exhortations about the obligation of schools and enterprises to provide meaningful activities for youth in their spare time. Most directly related to schools are the various extracurricular activities sponsored by the FDJ and other youth organizations. Among the more strongly recommended of these are competitions and comparisons of achievements, activities not restricted to sports but encompassing social science, foreign languages, science, technology, culture, art and military skills. Officials considered these competitions not as ends in themselves, but rather as an integral part of the process of political and educational work in school. The objective is not merely to win contests, but to enable young people to "perform creatively and to shape their political-moral profile on the basis of the philosophy of the working class." (21) The essential element in

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the activities of groups such as the Young Traffic Assistants or the Young Firefighters Assistants is progress toward the creation of "steadfast socialist patriots and enthusiastic proletarian internationalists," not the collection of trophies.

The activities of the Young Pioneers, a group for children between the ages of 6 and 13, illustrate official efforts to utilize leisure time. The Pioneers are given the opportunity to demonstrate their enthusiasm for the SED's economic objectives by collecting old paper, rags, glass, and other items that can be recycled into the GDR economy. One Pioneer group spent several weeks helping a factory meet its export order to the USSR by sorting buttons according to color. Free time can also be used to master the fundamentals of Marxism-Leninism so the Pioneers are organized into 6800 study groups which supplement the formal educational system. They are also encouraged to use their leisure time to help old people by shoveling coal or shopping for them. Over 400,000 youngsters support this objective through the 2600 Timur Centers established in the GDR. (22)

An additional way of providing meaningful spare time activities is specified in Article 45 of the Youth Law. Holidays and tours are to be provided for the nation's youth. In Article 46, the responsibility for preparing and implementing holiday programs for all pupils is placed in the hands of local government, managements of enterprises, and school officials. (23) The emphasis of these activities is on objectives which satisfy political goals. Planners are encouraged to arrange tours to other socialist nations, especially the USSR, to promote proletarian internationalism. Student camps and international student exchange programs achieve the same purpose. Tourism figures for 1977 demonstrate the success of this effort as over 124,000 East German Youths traveled to other Communist Party states. This represents an increase from 109,000 for 1976 and 107,000 for 1975. (24) Tourism, it must be noted, is not the only device by which proletarian internationalism is encouraged. The FDJ has organized numerous friendship brigades which assist with economic projects throughout East Europe and the FDS's Junior Partners, the Pioneers, have concluded 1800 "Friendship treaties" with Soviet Youth groups. (25)

Since anything which occupies an important place in the leisure time pursuits of youth is a concern of the party, even dance programs must be designed to meet political requirements.

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FDJ publications provide specific guidance on how to develop musical programs consistent with the Youth Law. (26) The same approach is applied for the benefit of young people in the military. (27) In all of this, the law requires expanded development of "collective forms," thus discouraging any "anti-socialist, individualistic" tendencies.

This review of the educational objectives of the SED would not be complete without consideration of one more important aspect of the campaign to mobilize youth: the effort to develop learning motives. This endeavor begins with children in the Pioneer organization, and continues on into the adult years. The objective is that children see political-ideological principles as the prerequisites for their lives. GDR educators regard the development of political-ideological learning motives as a complicated process requiring great demands on the skills and energies of Pioneer leaders. Therefore, it is a process which they have examined very carefully, scientifically, they say, in order to determine the best approaches. The conclusion of their examinations is that the development of learning motives is regulated. The crucial years for emotional conditioning are identified as the ages of 10 to 13, the final years of Pioneer membership. If the children are properly guided during these years, the result, GDR educators insist, will be a harmoniously developed personality for whom political-ideological goals are the immediate motivating behavioral force. (28)

The ideological controls imposed on East German young people have been clearly stated by numerous officials. Professor Hans-Joachim Bohme, an SED Central Committee member and Minister for University and Technical School affairs, expressed official expectations most emphatically when he demanded that students must understand their "study tasks from a class standpoint." Their political allegiance to the GDR and to socialism, Bohme declared, must be expressed not simply in slogans, but, above all, in high performance motivation. Educators, he insisted, must create an atmosphere of intolerance against the ideology of mediocrity and manifestations in indolence and indifference in studies. (29)

The Militarization of East German Youth

The new Youth Law makes its contribution to this litany in Articles 24 and 25:

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> It shall be the task of all young people to acquaint themselves with defense policy, acquire pre-military knowledge and skills and to serve in the National People's Army and the other armed services . . . Officials and managers, teachers and instructors . . . shall promote educational activities in the field of defense policy, pre-military training and civil defense as well as military sports . . . Special attention shall be given to enlisting and preparing young persons for military occupations. (30)

In the view of East German officials, the new law will assure the further satisfaction of Lenin's dictum that all revolutions worth anything must be able to defend themselves.

A necessary element of defense capability, authorities assert, is a proper image of the GDR's enemies. This applies with special force to questions regarding the character of Western nations. Publications such as *Militarwesen* have been stressing for some time that detente does not mean that there are common points between the soldiers of the National People's Army (NVA) and the West German army. This is coupled with demands that any illusions about imperialism be dealt with quickly by officers and NCO's. Emphasis on the proper "foe image" is not limited to those in the armed forces. In 1974 the GDR Ministry for Public Education circulated a letter to parents of school children informing them of their obligation to help their children conceive of GDR soldiers as defenders of the peace who make it possible for them to play in safety. At the same time, they are admonished to prevent their children from coming into contact with Western radio or television programs. The objective, according to the Ministry's letter, is to begin with "the small children to instill love for their worker and peasant state." (31) The East German youth media has been using a variety of themes to create the required "foe image." One approach has been to alert young readers about the "revanchist" activities of many Western youths, especially those active in organizations calling for return of the "lost" German territories. (32) A related theme is seen in the publication of numerous charges about Nazis still free in West Germany, such as, for example, the account about six "SS murderers" in Hamburg who had avoided prosecution for their crimes. (33) An additional tactic involves the constant recitation of figures about American troop strength around the world and

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any new developments in the military technology of the Western powers. (34) In this fashion, the leadership evidently hopes to convince its young citizens that the West is still a hostile and forbidding zone intent upon undoing the results of Nazi Germany's defeat. Even apparent changes in Western policy must not be taken too seriously for, as Admiral Waldemar Verner warns:

> . . . There is no room for illusions about imperialism and its readiness to engage in military adventures. So long as this system exists, we cannot rule out sudden changes and even temporary aggravations of the political climate. (35)

Accordingly, authorities instruct young people to be mindful of what Verner and others refer to as their "military class mission." Each year the FDJ and the GST conduct a nationwide military training project designed to involve the GDR's youth in actual field training. This project and other special efforts conducted among young Army personnel stress political education, combat training, and the military obligations of young citizens. The official view is that while it is a disgrace to serve in the Western military, it is an honor to be a part of the East German forces. The FDJ reminds young people of the honorable nature of military service by keeping in contact with members in the service and urging them to speak at FDJ meetings on what they have learned in the military. The supportive role of the FDJ draws frequent praise from GDR authorities such as Defense Minister Heinz Hoffmann who declared that the "socialist youth association represents one of the greatest of potencies which no imperialist army has available to it . . ." (36)

The effort to present military service as an honor has been aided by the early commencement of pre-military training in the GDR. For several years East German authorities have called for an intensification of pre-military training for children during the first years of school. The Pioneer organization works to develop militarily oriented thinking among its membership through "military model building, close cooperation with the NVA for training, military sports competition, and "Pioneer maneuvers" in which members acquire actual field training. Such events are now regular features of the class schedule in the GDR and in preparation the maneuvers competitions are held to select the "most athletic girl" and the "strongest boy." Physical education programs are designed as preparation for the

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so-called "8 Test" for NVA recruits. (37) Games such as "Weisel ruft Eidechse," an armored tactics game for nine year old children, demonstrate the sophisticated nature of premilitary training in the GDR. (38) Of even more immediate military application are the numerous devices for familiarizing children with the use of firearms. Typical of these is the well-equipped training center in Juteborg which since 1953 has trained elementary school children in the fundamentals of marksmanship. (39)

Although military education has been stressed since the creation of the GDR, until 1978 it was not a formal component of the school curriculum. Since that time, according to East German education journals, all subjects – from sports to history to music – must serve the cause of military education.(40) There has been a simultaneous expansion of GST training bases and instructional facilities in order to meet the SED's call for an additional intensification of military propaganda. The tone of much of this effort was demonstrated in an East German textbook entitled *Civil Defense* which is used in GDR schools. According to this text, which was examined by a West German newspaper in 1979, there is a "real danger of war" because the West is contemplating a surprise nuclear attack. (41)

Since military training is integrated into the overall school program it is instructive to see how such programs are implemented. An issue of *Volksarmee* described premilitary training as conducted in a high school in the Frankfurt/Oder Bezirk, the Geschwister Scholl school in Bernau. The faculty itself provides the first indication of what is required for the military training program; seven of the thirteen male instructors are reservists and the director is a reserve officer. Official support is reflected in the requirement that every teacher report three times annually on the handling of "questions of socialist defense education" in his classes and in the numerous reported discussions of national defense at meetings of the Parent Advisory Board. The school grounds are used during class time for practice in throwing hand grenades, creeping and crawling, and the use of map and compass. The students' leisure time is also subject to official demands since "defense sport has become a component part of a meaningful and interesting way of using free time." The success of their program is demonstrated by the fact that almost half of the graduate males are now officer

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candidates. (42) Reports that more than 90% of all males below draft age now participate in premilitary training indicate that the Geschwister Scholl School is typical of others in the GDR. In numerous accounts, East German authorities boast that the nation's young people are better prepared for military service than ever before. Yet the boasts are coupled with warnings such as that of Central Committee member Werner Hubner who declared that the "enemy" always interferes with any socialist defense education. Any such measure, he cautioned, is "subject to diversionary activity." (43)

The SED's Youth Policy: Problems and Prospects

According to the SED leadership, each person must strive to set a socialist example, to be worthy of the sacrifices of those who have created the "first socialist state on German soil." Thus, the party's program is geared toward the creation of new socialist personalities who will identify completely with the goals of the party and adopt the party's aspirations as their personal dreams. The youth organizations and the schools are agents of the SED in the campaign to mobilize young people for service to the state and have as their immediate responsibility insuring that each young person seek to live an exemplary life, to be worthy, as the Pioneers are exhorted, of the legacy of Thaelmann.

Numerous analytical difficulties prevent a precise measurement of the success of the GDR's youth policy. Furthermore, it is difficult to evaluate personal attachments to a system with any certainty. Many positive success indicators are apparent today. In both private and public conversations as well as in their behavior, young people display a strong functional commitment to their system. Their expressions of support for the ideology supporting the social and economic institutions of the GDR are somewhat less emphatic. The depth of symbolic and cultural commitments are equally difficult to assess. For example, the university students in Rostock who refused to respond to directives that they assist in clearing snow following severe winter storms in 1979 clearly did not demonstrate behavior indicative of a commitment to the attitudinal values of the system. The tone of the denunciations in the press show that authorities saw this as evidence of a failure of attitude, at the very least. (44) The refusal of young workers to work

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extra shifts to make up for plan arrears is another negative indication of this same category. (45)

Even more serious is the tendency of many East German young people to simply disbelieve much of what they are told, especially about the West. Touching on this question, the Halle daily *Freiheit* editorialized that the young citizens of the GDR "know imperialism only from history books" and therefore have a harder time in recognizing the true "nature of imperialism." (46) At the same time, the SED journal in Frankfurt/Oder felt obligated to run a commentary entitled "Why Do We Need Armies?" in an effort to answer questions about the necessity of military training. (47) Following the Soviet invasion of Afghanistan, this questioning attitude led to open protests. In Dresden four GDR students at the technical university were arrested in connection with their efforts to collect signatures for a petition denouncing the USST's military move. In numerous other incidents anti-Soviet slogans appeared in public places.(48)

Less political but nevertheless troubling is the persistence of "anti-socialist behavior" among the GDR's youth. SED Politburo member Konrad Neumann has described youthful anti-socialist behavior as a "lack of comradeship, a lack of will to learn and work, dishonesty and self-satisfaction over achievements." FDJ members, Neumann maintained, must combat this by working to increase their ideological influence on fellow-students. (49) Anti-socialist behavior is frequently expressed in more direct terms than those cited by Neumann. Juvenile Judge Ilse Lungwitz of the East Berlin Municipal Court has spoken of a variety of criminal offenses committed by young people. Her catalogue of youthful crimes includes

> . . . Offenses against property, mostly directed against socialist property or personal property. Another typical juvenile offense is in the illegal use of motor vehicles. Next in line are hooligan offenses. (50)

In 1978, Gerhard Neuner, president of the Academy of Pedagogical Sciences, warned of the "restlessness potential" of GDR youth. His warning plus the disorders in 1977 at the Alexanderplatz in East Berlin and later in Wittenberge, Erfurt, Leipzig, Havelberg, Frankfurt/Oder, and Schwedt clearly indicate that East German young people are less obedient than in the past. Irene Blumenthal, speaking at the Synod of the League of the Evangelical Churches of the GDR, spoke of a "new aggrieved

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group" —addicts, loafers, the drunk youths frequently seen in East German train stations, and others — which might include 10 or even 15 percent of the nation's youth. (51)

In searching for an explanation for these failures, the popular press in East Germany generally cites the influence of imperialist ideology or some other ideologically acceptable palliative. Specialized publications, however, focus on shortcomings in the nation's educational system. Konrad Naumann's 1975 article in *Deutsche Lehrerzeitung* set the tone for much of the criticism with its denunciation of "empty slogans about the word communism" in a passage dealing with the content of high school education. The political-educational level of communist education, Naumann explained, is not raised by referring to things as communist which are not even socialist. (52) More recently, Margot Honnecker, the GDR's Minister of Education, complained that the educational task of the schools was being placed above the more important responsibility of personality formation. (53) Shortcomings in popular support for military education are also blamed on the schools. For example, in 1979 *Deutsche Lehrerzeitung* complained that stereotyped repetition of phrases in military instruction was reducing its effectiveness and attraction to students. (54) There have also been complaints that some coaches think military training and the discipline that it is designed to instill are superfluous. (55)

If the educational system is falling short of the standard in developing a disciplined attitude, it is also suffering from a diminishing effectiveness in encouraging young people to continue their education into the college and university level. An inspection of students active in youth brigades in 1978 revealed that only 3.7% of them were preparing for higher education.(56) National figures for college enrollments in the 1978/79 school year support this negative projection. According to official statistics, there was a 21% drop in college attendance between 1972 and 1978. (57)

The student work brigades themselves, one of the FDJ's best-publicized operations, are also beset by problems. This is not to say that the program is an absolute failure, but rather that it has fallen below expectations in a number of respects. For example, there are numerous complaints about the methods used in recruiting students for youth projects as well as the burden placed on students who find their vacations unbearably

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shortened by service on the brigades. In many cases there are no assignments for girls even though they have been sent to project sites. Complaints also focus on the charge that the brigades are simply "vacation relief" for the permanent work force. (58) Other critics argue that efforts to overcome arrears in plan fulfillment have completely obscured the educational aspect of the program which was originally cited as justification for employment of non-paid student laborers. (59)

The youth organizations, the invaluable assistants in the educational process, are not immune to criticism either. There have been complaints about dwindling discipline among the Young Pioneers and the occasional voicing of anti-Soviet remarks by Pioneer members. (60). According to Young Pioneer chairman Helga Labs, the political work of the organization is deficient in several respects. Most important, she complains, is that "education in communist morality" is not always accomplished to the necessary degree. (61) While there have been fewer direct criticisms of the FDJ, there is a pattern of increasing demands on the organization and a tendency to make it responsible for an ever widening range of youthful behavior. (62)

Is the SED's youth policy a success? The response, whether negative or affirmative, must be a qualified one. Much has been accomplished of both substantial and superficial quality. There are numerous instances for citation. Youth travel to socialist countries is increasing. Participation in pre-military training is almost universal and the program is serving military needs by raising the performance of recruits. And in spite of their problems, the youth brigades do exist and that alone is some measure of success. But are these the absolute criteria for gauging success? Can data on these projects in fact verify the development of personal commitments? Considering of the uncertain link between attitudes and behavior, it seems unlikely.

GDR youth policy moves in two directions. One trend demonstrates the use of normative and material assets to encourage personal involvement. Scholarships, prefered jobs, and material benefits are the rewards for demonstration of regime support. The SED also uses persuation to achieve its objectives and educational endeavors play a major role. The 1974 Youth Law is important in this context because it reflects the function of socialist law as an instrument of social policy and as an educational mechanism.

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The setbacks cited above are not irreversible. They signify an incomplete realization of some of the objective of the SED's youth policy rather than an absolute failure. By the end of this past decade, recognizing its difficulties, the SED demonstrated its flexibility by calling for yet another modification of its policies. In a move aimed at compensating for failure to achieve one of its most fundamental aims, the formation of socialist character or personality, East German authorities conceded that while the state institutions may provide excellent sanitary conditions, only the parents' house can provide the extraordinary amount of attention and care needed for proper character formation. In discussing this change, the SED's theoretical collaboration between parents, schools and other social forces." (63) By this action, rather than concede authority to the family, the SED shows its determination to require even family relationships be directed towards the reinforcement of the socialist state whose policies are comprehensive and embrace the total society.

FOOTNOTES

(1) *Kolner Stadt-Anzieger*, December 17, 1975, p. 6.
(2) Alexander Dallin and George W. Breslauer, *Political Terror in Communist Systems*, (Stanford, California: Stanford University Press, 1970), Chapter One.
(3) *Ibid.*, pp. 81-82.
(4) Gabriel A. Almond and Sidney Verba, *The Civic Culture*, (Boston: Little, Brown, Inc., 1963), p. 354.
(5) Klaus Franke and Gerhard Krause, *Kommunisten und Jugend in der DDR*, (Beverly Hills, California, Sage Publications, 1975), pp. 67-69.
(6) *Neuer Weg.*, No. 14, July, 1973, pp. 628-630.
(7) *Wörterbuch zur Sozialistichen Jugendpolitik*, (Berlin: Dietz Verlag, 1975), p. 251.
(8) Willi Keil, Jürgen Trobisch, and Lothar Tyb'l, "The Strengthening of Proletarian Internationalism and Socialist Patriotism," *Deutsche Zeitschrift fur Philosophie*, Vol. 23, No. 11, November, 1975, pp. 1400-1401.
(9) *Jugend Gesetz der DDR*, (Berlin: Staatsverlag der DDR, 1975), pp. 10-57.
(10) *Junge Generation*, No. 4, 1976, p. 68.
(11) *Deutsche Lehrerzeitung*, No. 38, September, 1975, p. 3.
(12) *Ibid.*
(13) *Ibid.*
(14) *Neuer Weg*, Vol. 34, No. 15, August, 1979, pp. 583-586.

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(15) *Jugend Gesetz der DDR*, p. 17.
(16) *Junge Welt,* June 10, 1976, p. 5.
(17) *Einheit*, No. 11, November, 1975, p. 1277.
(18) *Ibid.*, pp. 1279-1280.
(19) *Ibid.*, No. 1, January, 1976, p. 3.
(20) *Jugend Gesetz der DDR*, p. 43.
(21) *Deutsche Lehrerzeitung*, Vol. 23, No.1, January, 1976, p. 3.
(22) *Einheit*, No. 12, December, 1978, pp. 1266-1270.
(23) *Jugend Gesetz der DDR*, p. 43.
(24) *Fragen und Antworten zum Programm der SED*, (Berlin: Dietz Verlag, 1980), p. 216.
(25) *Horizont*, Vol. 11, No. 48, November, 1978, p. 3.
(26) *Junge Generation*, No. 6, June, 1976, pp. 21-26.
(27) *Armeerundschau*, No. 5, February, 1976, pp. 10-13.
(28) *Padogogik*, No. 2, February, 1974, pp. 146-157.
(29) *Einheit*, Vol. 34, No. 1, January, 1979, pp. 46-53.
(30) *Hochschulwesen*, Vol. 27, No. 2, February, 1979, pp. 40-45.
(31) *Neuer Weg,* Vol. 34, No. 1, January, 1979, pp. 7-9.
(32) *Jugend Gesetz der DDR*, p. 43.
(33) *IWE-Tagesdienst*, February 2, 1974, p. 1.
(34) *Armeerundschau*, No. 12, December, 1972, pp. 44-47.
(35) *Junge Welt*, June 9, 1976, p. 7.
(36) *Armeerundschau*, No. 7, July, 1976, p. 71.
(37) *Junge Generation*, No. 2, February, 1974, pp. 60-61.
(38) *Volksarmee*, Np. 15, April, 1979, p. 2.
(39) *Die Welt*, March 31, 1979, p. 3.
(40) Horst Henckel, *Wiesel ruft Eidechse*, (Berlin: Verlag Junge Welt, 1972).
(41) *Visier*, No. 8, August, 1976, p. 1.
(42) *Deutsch Lehrerzeitung*, Vol. 26, No. 26, June, 1979, p. 4.
(43) *Rheinischer Merkur* (Koln), No. 23, June 8, 1979, pp. 10-11.
(44) *Volksarmee*, No. 7, February, 1974, p. 11.
(45) *Einheit*, Vol. 34, No. 8, August, 1979, pp. 871-877.
(46) *Forum*, Vol. 33, No. 2, January, 1979, p. 6.
(47) *Freiheit*, January 31, 1979, p. 6.
(48) *Ibid.*, March 1, 1979, p. 6.
(49) *Neuer Tag,* March 2, 1979, p. 3.
(50) *Der Yagesspiegel*, February 23, 1980, p. 2.
(51) "Voice of the GDR," August 10, 1976.
(52) *Junge Welt,* December 1-2, 1973, p. 3.
(53) *Frankfurter Rundschau*, December 5, 1978, p. 3.
(54) *Deutsche Lehrerzeitung*, No. 38, September, 1975, p. 3.
(55) *Deutschland Archiv.*, Vol. 11, No. 12, December, 1978, pp. 1251-1253.
(56) *Deutsche Lehrerzeitung*, Vol. 26, No. 26, June, 1979, p. 4.
(57) *Deutschland Archiv*, Vol. 13, No. 1, January, 1980, pp. 77-83.
(58) *Freiheit*, January 31, 1979, p. 6.
(59) *Informationen*, No. 19, December, 1979, pp. 8-10.
(60) *Forum*, April 8, 1974, p. 3.
(61) *Rheinischer Merkur* (Koln), No. 22, June 1, 1979, p. 9.
(62) *Frankfurter Rundschau*, December 13, 1978, p. 3.
(63) *Einheit*, Vol. 34, No. 11, November, 1979, pp. 1157-58 and *Deutschland Archiv*, Vol. 12, No. 12, December, 1979, pp. 1311-1315.

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FAMILY PLANNING PROGRAMS AND FERTILITY DECLINE

By Roberto Cuca

The developing world, taken as a whole, experienced a consistent increase in the rate of growth of its population from 1945 up to the late 1960s. The rate then stabilized at around 2.4 per cent per annum, and in the mid-1970s it dropped to 2.3 per cent. Although this decline may not appear dramatic, the change of trend it implies is of tremendous importance in the history of population. For the first time in the modern era, the rate of population growth is declining rather than increasing. (Even at this reduced rate, of course, the number of people in the world will continue to grow rapidly, so that a decline in fertility must not be confused with a decline in population.)

The steady increase in the rate of population growth of most developing countries in the post-World War II era took place because of a continuous decline in mortality, while fertility remained constant or even increased somewhat up to about 1960. The data on fertility for the purpose of this article are based on estimates of the total number of live births that each woman would have during her lifetime, if current age-specific fertility rates were to continue unchanged. During the 1960s, fertility began to decrease, but still not as fast as mortality; it was not until the 1970s that fertility decline overtook falling mortality, and the rate of population growth finally began to slow down.

This article is based on a World Bank study of 63 developing countries to determine the conditions that may have brought about the decline in fertility in the developing world during the last two decades. Three principal findings are relevant for policymakers: birthrates fell most in countries that had adopted and implemented family planning policies and programs with specific demographic objectives; they fell less in countries with family planning policies but no demographic objectives; and fell least of all in countries without family planning programs. The analysis also shows that the adoption and implementation of family planning programs, as well as their success, were directly related to each country's socioeconomic development. (This

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development was measured by such key indicators as school enrollment; health and nutritional status; income; occupation; sanitation and urbanization; and the status of women.) Although it is difficult to establish the different roles played by the level of development and family planning programs in declining birthrates, the implications of the study for policy-making are that the practice of family planning and the consequent fertility decline depend both on the effective supply of family planning services and on sufficient demand for them. The results also indicate that both socioeconomic development and family planning programs have to be pursued simultaneously if fertility is to decrease in the future.

Critical Factors

The 63 countries covered in the analysis have populations of five million or more. They represent approximately 95 per cent of the population of the developing world, or about 67 per cent of the total population of the world. The chart shows the association between the degree of a country's official commitment to fertility reduction – through a family planning policy and program specifically aimed at reducing birthrates – and the reduction in its birthrate during the period 1960-77. Of the 26 countries with a specific population policy, 10 had a large reduction in the birthrate (10 per cent or more during the period of the analysis); of the 19 countries with a population policy but no specific objective to reduce births, only 6 had a large reduction in the birth rate; and of the 18 countries without any population policy at all, only 2 had a large reduction in the birthrate.

A clear association also emerges between a country's level of socioeconomic development and the reduction in its birthrate. Eighteen of the 20 countries classified as being relatively developed had large reductions in the birthrate, while only 10 of the 23 middle-level countries and none of the 20 low-level countries had a large drop in rates. There is a similar correlation between low birthrates and relatively high national per capita incomes. Nine out of the 13 countries with high per capita incomes (over US$1,000) in 1977 had large reductions in the birthrate; 16 countries out of the 30 in the middle-income range (between US$250 and US$1,000) had the same success; and only 3 countries out of the 20 in the low-income group (less

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then US$250) achieved large reductions in the birthrate.

In addition to the relationships shown in the chart, the Bank study also tried to measure the effects of the use of contraception on birthrates. First, the proportion of married women of reproductive age using contraception in a country was estimated. This figure was then related to the degree to which the country's birthrate fell below a level considered normal if contraception had not been practiced. Two assumptions were made in setting this level: that a rate of about 50 births per 1,000 persons implies natural fertility without contraception; and that for each 2 per cent of women of childbearing age practicing effective contraception, the birthrate would decrease by one point. (This last assumption was made on the basis of the experience and implies, of course, that the women practicing contraception are a random sample of all women of childbearing age. This is not always the case and therefore the relevant percentages will vary from country to country.) The analysis found a clear association between the practice of contraception and the reduction of fertility, although the ratio to the decline in the birthrate was not always in the expected relation of two to one.

The study shows that a country cannot be successful in significantly reducing fertility unless it has a relatively medium to high level of per capita income and social development and, as a minimum, a favorable official attitude toward family planning, if not a positive commitment to reducing the birthrate. The few exceptions to this rule found in the analysis only serve to confirm it. India, Sri Lanka, and VietNam have low per capita incomes but fall within the middle to high range of social development and are fully committed to fertility decline. Although Argentina and North Korea have no commitment to birth reduction, they are highly developed socially and are middle-income or high-income countries.

On the other hand, countries – such as Ghana and Kenya – with a clear official commitment to reducing birthrates have failed to affect them significantly because they have not developed effective programs. The other countries with low per capita incomes and low socioeconomic development were unsuccessful primarily because their socioeconomic environment was not conducive to the practice of family planning. In some cases – such as Iraq and the Syrian Arab Republic –

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Chart 1
Developing countries with a reduction in the crude birthrate of 10 per cent or more (in black), or less (shaded), 1960-77[1]

Relative social setting[2]	Per capita GNP, 1977 (In U.S. dollars)	Government policy on family planning		
		Policy with specific objective of reducing fertility	Policy but no specific objective of reducing fertility	No policy or negative policy
High	More than $1,000	Hong Kong Mexico Turkey	Brazil Chile Iraq Venezuela	Argentina
	Between $250 and $1,000	Colombia Dominican Republic Malaysia Philippines Republic of Korea	Cuba Ecuador Peru	North Korea Syrian Arab Republic
	Less than $250	Sri Lanka		
Medium	More than $1,000	Iran	Algeria South Africa	Saudi Arabia
	Between $250 and $1,000	China Egypt Ghana Guatemala Indonesia Kenya Morocco Thailand Tunisia	Zambia Zimbabwe	Bolivia Cameroon
	Less than $250	India Pakistan Viet Nam	Zaire	Burma Madagascar
Low	More than $1,000			
	Between $250 and $1,000	Senegal	Nigeria Sudan Uganda	Angola Ivory Coast Yemen Arab Republic
	Less than $250	Bangladesh Nepal	Afghanistan Haiti Mali Tanzania	Ethiopia Guinea Kampuchea, Democratic Malawi Mozambique Niger Upper Volta

Sources: World Bank, *World Development Report*, 1978 and 1979; Dorothy L. Nortman and Ellen Hofstatter, *Population and Family Planning Programs* (The Population Council, New York, 1978); W. Parker Maudlin and Bernard Berelson, "Conditions of Fertility Decline in Developing Countries, 1965-1975," in *Studies in Family Planning*, Vol. 9 (May 1978).

[1] Includes only countries with a population of at least five million in 1977; includes low-income and middle-income countries, capital surplus oil exporters, and centrally planned economies outside Europe with per capita gross national product (GNP) of less than $1,000.

[2] The index of social setting is obtained by dividing the countries into three groups containing about the same numbers of countries, on the basis of the index developed by Maudlin and Berelson (see source reference). Their index includes measures of adult literacy and school enrollment, life expectancy and infant mortality, men in nonagricultural activities, GNP per capita, and urbanization.

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unspecific or relatively weak commitment to fertility decline led to a low reduction in birthrates in spite of a relatively developed social environment.

Implementing Policies

Another relationship observed was that between the level of socioeconomic development and the adoption of a family planning policy. Of the 20 countries classified as high in socioeconomic development, 17 had favorable family planning policies; of the 23 countries classified as having middle-level socioeconomic development, 18 had adopted favorable family planning policies; and only 10 of the 20 countries classified as low in socioeconomic development had favorable family planning policies. The reasons for this are clear. In order to adopt a policy, a country has to be aware, first, that it has a population problem and, second, that a family planning program can help to solve it. For this awareness to exist, countries must have had some tradition of census taking and have experienced the typical discussions and debates that take place anywhere on the need to establish family planning programs.

Developing countries, particularly the poorest, seem to suffer most from these debates. These circumstances at least partly explain why they are the least willing to adopt policies to control population growth, and why they are less successful than other countries in their efforts both to generate demand for family planning services and to supply them. The difficulties of implementing family planning programs in the poorer developing countries are compounded by their lack of capacity to implement them, since a certain level of administrative efficiency is necessary to make a family planning program work. While these services may be initially met by private supply, the experience of most developing countries shows that only organized public programs have the means to supply these services to large numbers of people effectively in the long term. In countries with relatively low socioeconomic development, the public provision of services does not appear to be effective.

These proportions do not imply that, in general, countries with low per capita incomes cannot be successful in reducing birthrates. Other factors, such as the social environment, play an important part in this process. India, Sri Lanka, and Viet Nam have low per capita incomes but not the lowest social

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development, and, with strong official commitment to planning programs, they have substantially reduced their birthrates. For policymakers, the message is clear: modernization and social development can increase the demand for family planning services, and well organized programs can ensure the supply of such services. Both supply and demand working simultaneously tend to increase contraceptive practice, in turn, to lower birthrates.

Establishing Causality

The data in the chart show the relationship between declining birthrates, official commitment to family planning, and the socioeconomic environment. Is it the existence of a family planning program or a good socioeconomic environment that reduces birthrates? The most difficult task is to isolate the different causes of decreased fertility in order to find out how much of the decline is due to the practice of contraception or induced abortion, and how much is caused by socioeconomic factors. This exercise is complicated by the fact that socioeconomic factors affect fertility in different ways. For instance, socioeconomic development may raise the average age of marriage – which would be expected to reduce fertility – but may cause an increase in premarital sexual intercourse – which, in the absence of contraception or abortion, tends to increase fertility. Again, socioeconomic development appears to increase the number of live births and therefore to decrease fertility, since the occurrence of one birth delays the time of a new pregnancy. The development process may also increase rather than reduce fertility by decreasing the prevalence of sterility and the practice of lactation (which tends to delay conception for some months after the birth of an infant).

Little work has been done to explain the influence of these factors on fertility. Some studies, such as one in the Republic of Korea, have identified the contribution of the increase in the age of marriage and the change in the relative proportions of persons of each age group in the total population to declines in the birthrate. Evaluations of family planning programs in different countries have also estimated the number of births averted as a consequence of contraceptive practice, but these efforts may have been vitiated by defective data and by the assumptions made and are often, therefore, not fully convincing.

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These problems have been complicated rather than clarified, oddly enough, by research efforts into the determinants of fertility. The main reason is that such efforts have concentrated on finding the correlation between indicators of socioeconomic development and those of changing fertility levels, but without considering the intermediate variables – such as age of marriage or the proportion of married women – that are affected by socioeconomic factors, and that in turn affect fertility. Another weakness of this research is that, with few exceptions, the studies have not considered the availability of family planning services. This is surprising considering that much of the research has been undertaken by economists who would be expected to use the same approach used in studying the market for other goods and services, which would look into both supply and demand functions.

Demographic Data

Reliable evaluation assumes the availability of reliable data. Lack of data on population explains why in many cases trends in fertility cannot be ascertained. By the early 1960s many countries had not even taken a population census, and statistics on vital rates were either unavailable or so unreliable that observed changes could not be accepted with confidence. Lack of data to estimate changes in fertility gave rise to the use of statistics from family planning program services to evaluate the programs. The emphasis on the achievement of targets for family planning programs, however, produced falsification of data in some countries. This raised questions about their reliability.

There have been several efforts since then to improve the situation. The United Nations has established a census program; national programs now exist to improve birth registration; sample surveys are more widely used than before; and techniques of estimation based on incomplete data have been developed.

The lack of reliable data has been one of the principal problems in assessing changes in fertility in the past. The most important problem, however, has been that of attributing the identified reductions in fertility to either socioeconomic development or to the action of family planning programs. But since birthrates mostly fall when both the supply of family planning services and the demand for them are matched, substantial

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reductions in fertility will only be achieved when both are affected. Thus, it is advisable to invest in fields which accelerate development — in order to increase the demand for family planning programs to increase the supply of services. Development, of course, takes time. But it is reassuring that even at low levels of development there appears to be a demand for services that can be met with strong family planning programs, which, if effective, may accelerate development by reducing the problems of overpopulation.

The question for researchers is not whether they can discover the socioeconomic determinants of fertility, but whether they can identify the effects of social and economic factors that directly affect the desire for low fertility and the factors that affect the supply of acceptable family planning services. The answer is not to abandon the efforts but to redirect them.

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CHANGING PATTERNS IN THE MIDDLE EAST GOLD MARKET

By Timothy Green

The Middle East has long played a significant role in the world of gold, but in the last few years it has become a crucial cornerstone. The understanding of, and participation in, the international gold market by many individuals, bankers and governments in the Middle East, is much wider than a decade ago.

Before proceeding, however, one definition. In the context of this paper, I am taking the Middle East as the broad sweep of Arab speaking nations from Morocco right through to the Gulf, I am including also Turkey, because the attention to gold there is very similar (and it is largely Middle East supplied), Iran, and also India/Pakistan, whose gold has arrived for a generation now, primarily from Middle East entrepots.

So where does this vast region stand in terms of the gold demand? Putting numbers on it nowadays is difficult, because one can track only the gold that moves there; that bought by Middle East operators in Europe or America on metal account, for investment portfolios, or in speculative flings on the futures markets can only be guessed at.

The Recent Past

What one can say is this. In each of the three years 1976-78 roughly 350-400 tons of new gold coming on the market passed to the Middle East in bar form, and if we count, too, the immense amounts of jewellery dispatched there from Italy we end up with closer to 450 tons of new gold being destined for the Middle East in peak years 1976/77 and about 350 in 1978. (By comparison the United States was 300 net in 1978). That is over 25% of all gold coming on the market in 1976/77 and 20% in 1978. Since then, as the gold price has risen sharply, the physical offtake has fallen dramatically. In 1979 it was scarcely 100 tons, and in 1980 the region became a substantial dishoarder of gold back to the European market. In the first half of 1980 at least 150 tons of melted jewellery and coin was sold back to London and Zurich.

Such variations in physical demand only serve to underline

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the Middle East as a major force in gold. The speculative/investment activity, of course, is on top of it,

In looking at the changing patterns of Middle East markets, I would like to focus on three clearly defined aspects:

First: the physical gold that actually moves there.

Second: the speculative and investment activities of private wealthy individuals or private institutions participating in Europe or in an American or Far Eastern trading centre,

Thirdly: at the attitudes of central banks or government investment institutions.

To begin with the markets or distribution centres: Once upon a time this vast region was supplied essentially through Beirut and Dubai (except for Morocco and Algeria which have long enjoyed an unofficial French/Belgium connection).

During the last few years, however, regional markets have proliferated, partly as a result of the Lebanese civil war, but also as a result of better communications. It is remarkable the effect that the installation of good telephone and telex links can have on a nation's participation in the gold market. A few years ago local dealers in Saudi Arabia, for instance, only knew the gold price a day late by cable (if they were lucky). The Saudi market, such as it was, was totally a subsidiary of Beirut.

Today the Saudis are able to flex their much greater financial muscle in the gold market because the telex links exist. Consequently Jeddah has become an important market for physical gold, and both Jeddah, Riyadh (and even Daman) are very active daily in international gold trading.

The decline of Beirut has also led to much greater activity, in both physical gold and trading, being channelled through Kuwait, and now Bahrain (where the rapid growth of offshore banking is making it a convenient centre for speculative or investment activity). Teheran was also starting to take considerable supplies of bullion directly from London and Switzerland until the revolution, but since the Shah's overthrow private business has been at a standstill.

The situation in Beirut is such that gold does move there to the airport, but its security cannot be guaranteed on the road into town, so that essentially a transit business is done at the airport itself and it is then spirited onwards to neighbouring countries. But the days when the big exchange dealers kept large stocks in their offices are over. What remains through

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Beirut is some international trading, concentrated chiefly through one bank, acting for a wide Middle East clientele. No security risks are involved in such trading, of course.

Present-day Gold Centers

So in the Middle East today, the gold centres are Beirut, Kuwait, Bahrain, Dubai, Jeddah, Riyadh. Teheran is in *limbo*. They act both as distribution centres for their own gold needs or those of their neighbours (usually unofficial), and as catchment centres to relay trading activity. Unlike Hong Kong or Singapore, however, there are no actual gold exchanges.

One additional point is that traditionally much of the gold business in Middle East has been through exchange dealers, as opposed to fully fledged banks. This custom still prevails to a considerable degree (in Kuwait for instance they still handle the major part), but banks are starting to play a bigger role.

Now let us consider the physical gold business in the area embracing nearly a billion people. Realize one common characteristic of this vast area. The banking systems and the stock markets just cannot be compared to the United States, Western Europe or Japan. The ordinary farmer, or peasant, nomad, or even construction worker in the burgeoning cities, knows and understands little of savings banks, still less of futures or option markets. The surplus cash of a farmer anywhere from Morocco to India, therefore, goes into relatively crude gold jewellery, usually 22 carat, sold at an exceptionally low markup (30% over gold content or into gold coins such as sovereigns), Mexican pesos, double eagles or various local coins such as the Reshad in Turkey or the Pahlavii in Iran – almost all of which are locally made. Thriving coin factories exist in Syria, Kuwait and Saudi Arabia turning out any coin for which there is a demand, sovereigns or U.S. dollars included. They are, of course, fakes, but no one tries to hide this. If you ask about sovereigns in Jeddah, they will tell you quite openly that they are locally made.

Investment Jewelry

So the farmer in India, or the migrant worker from Yemen or Egypt involved in some construction project in Saudi Arabia will usually put his spare cash into gold coin, jewellery, or

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perhaps in small gold bars (the ten tola bar of 3.75 ounces) or the 10, 20, 50 gr. bars which the Swiss have so successfully marketed in recent years. This is, if you like, the traditional hoarding, although I am trying to promote a new phrase 'investment jewellery'. Although most of the physical gold actually moving to the Middle East is in kilo bar form, the major part of it is manufactured into jewellery once it gets there. This is, I suspect, something against customary belief, but the research that I have done in every country there during the last decade makes it quite clear that *most* gold is fabricated into jewellery or coin once it gets there. It does not stay as kilo bars under the bed.

This trend to locally made investment jewellery increased between 1975 and 1978. Everywhere from Dubai to Bahrain and Kuwait to Cairo, more and more factories were established with imported machinery for mass producing jewellery. And until the revolution, nowhere could really rival Iran. I was somewhat sceptical about this until I was taken around a factory in Teheran and found a whole range of Italian chain machines chuntering away. The manufacturing group involved also had factories in Isfahan and reckoned to use 500 kg – half-a-ton of gold a week – that is Italian scale. Or put another way, more than the entire use of the jewellery industry in the United Kingdom, France or Switzerland.

One final point on this investment jewellery – or walking insurance policy if you like: anyone who has not visited the *souks* – markets – of the Middle East may not fully realize the sheer weight of gold involved in much of this jewellery. After all the conventional wedding ring in Europe weighs only 4 or 5 grams: in the dazzling array of gold jewellery in most Middle East souks you will find bracelets of 22 carat gold weighing anything from 20-50grams or more and people may buy several at a time. In some countries, such as Morocco or Egypt it is the custom for brides at marriages to wear a belt of solid gold that may weigh anything from 300 grams to 750 grams – depending obviously on the slimness or otherwise of the bride.

I go into this investment jewellery at some length because the question has been asked so many times since the enormous injection of purchasing power into the Middle East, as to what is happening to the vast amounts of gold actually going to such

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places as the Gulf and Saudi Arabia. The answer, frankly, is jewellery and coin fabrication.

Just to cite the example of Saudi Arabia. In 1978, 60 tons of gold moved there in bar form: a certain amount of this was re-exported – unofficially – to neighbouring countries; but upwards of 40 tons of that gold was made into jewellery or coin either in Saudi itself or in Bahrain or Dubai – that is quite aside from large orders for ready made gold jewellery placed by leading Saudi wholesalers with manufacturers in Italy.

Much of this jewellery, of course, was not bought by the Saudis themselves, but by the million or more migrant workers from Yemen, Somali, India, Pakistan, Egypt, employed on short term construction. They save much of their high pay and take home easily portable consumer goods – radio or cassette players and jewellery. The Haj pilgrims to Mecca also buy much gold to take home.

This demand for investment jewellery does fluctuate widely. As prices rose in 1979 and even faster in 1980, not only did jewellery sales fall sharply, but by January 1980 substantial trading in of gold ornaments was taking place in *souks* throughout the Middle East, as thousands of people took a profit on the bracelets and rings that they had purchased at lower prices. In the Kuwait souk alone upwards of three or four thousand people were trading in jewellery daily. It was being melted at once into rough bars, and dispatched by air to London and Zurich. Meanwhile jewellery factories in the Gulf states and Saudi all closed. This two-way business emphasizes the investment nature of much of the jewellery; it is like taking a profit on the stock market when it is riding high. And since it is purchased initially on low marks-ups very good profits can be made.

Before turning to the investment/speculative activity, one special case – Turkey – must be considered. Turkey has presented the classic example of a nation reaching for gold as a lifebelt as its economy collapses. The direct import of gold is, of course, forbidden but it arrives clandestinely and is made into jewellery and coin, and gold has become *the* basic form of saving in the cities and the countryside. European families I know in Istanbul have even taken to keeping any savings in gold coin. The purchasing power is there because of the large number of Turkish migrant workers employed in West Germany. Their

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D.M. earning remitted unofficially to Turkey provide the hard currency to buy the gold.

By contrast India, that traditional sponge for precious metals, has not kept pace with the rising gold demand. The reason is two-fold: first, Mrs. Ghandi, during her period of direct rule, effectively smashed all the big smuggling groups and they have not really grown up again. Secondly, purchasing power in India has not risen in tandem with the oil rich Middle East.

Indeed, if you look at the last decade in India, you see they have imported (illegally) about $200-$250 million in gold each year: at the old $35 that accounted for over 200 tons: at today's price it buys only 10-12 tons.

Participation in Auctions

The decline in physical gold business with the Middle East since 1978 has been more than compensated for by rapidly growing investment/speculative business *loco* Zurich, London and New York. The list of bidders at IMF and U.S. Treasury auctions for instance during recent years has included the names of quite small commercial banks in the Gulf often bidding for large amounts. One bank bid for a million ounces at U.S. Treasury auction in 1979 (but didn't get it).

Such bids demonstrate two things: first, obviously, that the new financial muscle there is being flexed, but, more important perhaps, that speculators *want* that flexing to be observed. They are fully aware of what such a bid can do to the market, for, the reaction of the innocent may be 'aha! the Arabs are buying', so a speculator will choose carefully through whom the bid is made to create a sensation.

After all if he bid instead (as many Middle East investors do) through the Swiss bank, a London dealer, or even the distinguished German banks that have figured so prominently in IMF and U.S. Treasury auctions he would not make half the impact. But play your card through a small Middle East bank and everyone starts talking.

So besides the money being there to play the gold market, it is being placed from time to time through unusual outlets to create maximum effect.

I recall many articles in Europe and American newspapers and magazines citing such bids as evidence of Arab oil men

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buying: which is precisely the effect intended.

It is, however, important to keep Middle East buying in perspective. There has not been any massive switch into gold, and certainly during the years from 1974-77 many speculators in the Middle East, especially in Saudi Arabia, found it much more profitable to speculate in land rather than gold: the profits to be made dwarfed anything achieved in the gold market. But since 1978 as the land boom has waned, while the dollar progressively weakened, more and more private Middle East money has gone into gold.

This buying takes two forms; it may be a purely speculative transaction — often for very large quantities — on Comex or on metal accounts. A relative handful of very large operators make periodic forays into the market from purely speculative motives. And while conventional purchases may be of 100 - 200 - 300 kg, a few may go for several tons at a time: such orders obviously can have a profound effect upon the market.

But what had also increased in the aftermath of the revolution in Iran is investment buying *loco* Europe of kilo bars that are regarded as a medium or long term hedge against political upheavals in other countries of the Middle East. The swiftness with which the Shah was ousted made others nervous, and as a precaution they quietly built up positions overseas. And, compared with the speculative flings, this gold may be held for relatively long periods.

Central Bank Holdings

So far I have been referring to private speculative/investment buying. But what is the attitude of central bank and government investment authorities?

If you consider the declared gold holdings of all Middle East countries they are miniscule compared with the industrial nations of Western Europe. In round numbers they are:

Saudi Arabia	150 tons
Kuwait	88 tons
U.A.E.	20 tons
Egypt	85 tons
Algeria	200 tons
Lebanon	323 tons

Compare this with U.S.A. at 9,000 tons, West Germany 4,000

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tons, France 3,500 tons or even Belgium with 1,500 tons, and you see how minuscule it is.

In all, the total declared reserves of the Middle East (excluding, for a moment, Turkey and India/Pakistan) are scarcely 1,400 tons of gold – less for instance than Belgium and half that of Switzerland.

Now what is the attitude of those countries towards gold? Clearly what really counts are the oil surplus ones, Saudi Arabia, Libya, Iraq and the Gulf States. Their reserves have been increasing at a vast rate – and have largely been in dollars.

Let's start with one example, Kuwait, because the gyrations of its published gold reserve figures in recent years have raised many questions. Its gold reserve apparently rose from around 100 tons in 1973 to well over 200 tons by 1977. But the reason was quite simple: until late 1977 the law in Kuwait required that *note issue* had to be 50% backed by gold. It was then changed to 100% backing in gold and foreign exchange, and since then the gold backing for note issue has been reduced to 20%. Now neither this build up of gold reserves nor the run down since 1977 involved open market operation: it was all handled by swops.

The attitude of Kuwait in divesting itself of this requirement to base its note issue with gold is interesting for it reflected two things – first an attitude that gold as a reserve was non-interest bearing, and second genuine political reluctance to buy a metal coming primarily from South Africa and Russia. Kuwait is not alone in this view. There is genuine reluctance in the Arab world, particularly where Palestinians are numerous – as in Gulf – to buy gold for reserves. The antipathy is *political* not *economic*.

It was also significant that one Middle East investment authority sold not only its gold shares but also gold holdings in 1977 for the same political reasons. But times are changing. The troubles of the dollar made several Middle East central banks and government investment funds think again. Since 1979 economic considerations have definitely overcome political scruple.

The attitude was put succinctly by the economic adviser to one Arab government organization which had bought a good deal of gold about three years ago (at a very advantageous price) initially for a special coin issue. When the coin flopped,

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they at first were inclined to sell the gold. But the events of 1978-79 persuaded them otherwise. They are happily sitting tight on their gold. "We consider it as a suitable asset" said the adviser. Nothing dramatic in that; but it is a sign of the times.

Another institution, a central bank, has actually increased the gold content of its reserves from 1% in 1976 to about 10% by the beginning of 1980 and intends to maintain at least that level.

This trend strengthened during 1980, when most central banks and government investment institutions in the Middle East participated in the gold market. Indeed one major reason the price stayed so strong through much of 1980 was an underlying basis of central bank buying. One or two Middle East oil producers made substantial gold purchases in the range $400 to $550 an ounce. This official buying must be kept in perspective; I am not suggesting a massive switch of reserves into gold, but rather a steady 'nibbling'. As the monetary reserves of the main oil producers keep on increasing, so a modest part (perhaps 5 or 10 per cent) is likely to go into gold. And that discreet under-tow of buying; mainly when the price is in a trough, is likely to be an essential factor in the gold price during the 1980s. Indeed, looking at this next decade, I would anticipate much higher official gold holdings in the Middle East. And for that reason, too, I expect the region to remain a cornerstone of the gold scene for many years to come.

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TWELVE THOUGHTS ON INFLATION

By William Hutt

Foreword

I wrote this contribution fifteen years ago, and I am indebted to Mr. R. M. Bleiberg, editor of *Barrons,* for permission to republish the major portion of this fourteen-year-old article.

It has been unnecessary to change a word in the essay itself. Apart from minor alteration in the first paragraph and the substitution of "Blacks" for "Negroes" under point 8, it stands just as it was originally written. What I wrote is as relevant to the problems of today as it was to those of 1965. No one has ventured to criticize or contradict any of the propositions I presented. Yet these twelve propositions amount to the strongest condemnation of the monetary policies of the last two decades. Deficit spending ("budget deficits") against which contemporary criticisim is mainly aimed, are simply one way of debasing money.

About twenty years ago, Arthur Burns, then Chairman of the Federal Reserve Board, said something to this effect: "I could stop inflation dead in its tracks. But it would cause joblessness." Economists took this to mean that he believed there was no politically acceptable method for society to avoid the overpricing of unionized labor and hence unemployment except through a continuous debasement of the dollar. It was precisely that which I categorically denied. And I deny it today.

The chief obstacle to full employment without inflation is the organized Trades Unions which ruthlessly oppose reforms calculated to increase the flow of real wages, for such reforms would reduce all wage-rates which have been forced above values compatible with market-clearing prices. Over sixty-three years ago, Edwin Cannan remarked that depression arises when the process of asking too much becomes general. About the same time an eminent Cambridge economist named Lavington, now almost forgotten, explained the same point in a splendid book *The Trade Cycle*, 1922. These economists saw that depression is not caused by a defect in society's *spending* mechanism

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but by a defect in its *pricing* mechanism. The debasement of currencies can to the extent to which the phenomenon is not generally perceived or predicted crudely rectify certain pricing defects. That is one major reason for the popularity of inflation.

The present writer's interest in the phenomenon of inflation goes back at least sixty years. He was then an undergraduate at the London School of Economics. The Edwin Cannan at whose feet he was studying, had taken the delightful gesture of suing the British Government under the Profiteering Act for selling pound notes at above their gold value. Cannan wanted to bring home to the public the extent to which inflation had debased the pound sterling.

As a teacher of business administration during the period 1928 to 1965 the writer's attention was repeatedly forced back to this question of the spasmodic, yet persistent, depreciation of money. How can businessmen coordinate the private sector of the economy effectively when the most important measuring-rod of all – the monetary unit – has been left with no reliable, defined value? Units of length, volume, and weight have been universally defined with meticulous care; but dollars, lire, francs, and pounds have been allowed to change in every significant attribute over time. Hence, the aim in this article is to record briefly the twelve most important practical conclusions to which the thought of an academic lifetime on this issue has led the author.

(1) Nearly all inflations have been intentional, calculated actions of governments, however reluctant they may have been. No monetary depreciation in history has ever occurred in which governments have not purposely taken the steps needed to bring it about or, alternatively, have not deliberately refrained from action which could rectify any inadvertently caused inflationary tendencies. If monetary systems had rested solely on private contracts to redeem credit instruments (according to some stipulated standard) inflation could never have occurred.

(2) From time immemorial princes debased currencies. To such an extent did this happen that almost invariably the emergence of representative government in different parts of the world was followed by legislation to remove the right of monarchs to reduce the metallic content of moneys. But curiously, with the transfer of the kingly power to parliaments, no similar constitutional limitations were imposed upon elected govern-

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ments. There have been suggestions in the United States, since the Second World War, that the continued decline in the purchasing power of the dollar should be brought to an end by incorporating the objective of a stable price index, by amendment, into the Employment Act of 1946; but the leadership which could have forced governments to take so difficult a step has thus far been lacking.

(3) When governments plan the programs which force up the cost of living they are usually reluctant. If they (or their advisers) could conceive of some means other than inflation for keeping their supporters happy they would make use of them; but provided the public generally does not predict the speed with which it is to occur or its duration, inflation accords governments an easy access to income — unauthorized by democratic process — with which to purchase popularity, as well as an easy means — although a clumsy and unjust means — of temporarily alleviating the most common causes of discoordination in an economic system.

(4) Inflation can serve as a sort of palliative or anaesthetic which deadens the pain of a serious economic disease, namely, discoordination due to different categories of prices coming to be wrongly related to one another. Various types of restraint on competition permit wage and prices to be fixed too high to permit the full flow of output to be purchased from uninflated income, or too high in relation to price expectations. When one kind of labor or its product is priced too high, the sources of demand for non-competing labor and products are reduced; and if prices generally are rigid downwards, a cumulative decline in activity is set in motion. In the absence of inflation, therefore, the symptoms of the discoordination so caused are unemployment and depression.

An organized depreciation of the monetary unit, however, may bring about some sort of recoordination of the price system, in spite of its injustice. *Under favorable conditions*, it can cause the prices realized for products to rise more rapidly than the costs of making them. This may render profitable the employment for some presently unutilized or under-utilized productive capacity. For instance, if costs such as wage rates have been fixed higher than the public can afford to pay for the full supply of labor, a slowing down of output, with unemployment, is threatened. Inflation can then raise prices in relation to

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costs and so keep the economy going. Similarly, if producer-dominated marketing commissions have forced up the prices of primary products (raw materials or food) so that the public begins to be unable to afford to buy all that is being produced, again inflation can, in a crude sort of way, rectify the position by validating the higher prices. But all this depends, of course, upon the public as a whole not expecting it.

Eventually the precipients of wages *as a whole* and the farmers *as a whole* receive no more for their services. Their persistent striving to squeeze more for themselves out of the common pool is self-frustrating because the prices of the things which *they* have to buy are equally forced up by the process; but elected labor union officials can often retain their jobs only if they can show that they have raised wage rates year by year; and organized farmers habitually think it right that they should be paid a little more each year for their products. Hence in this inflationary age, wage rates and primary product prices tend to be raised, again and again, above what the public could afford in the absence of concurrent inflation; and so it seems as if the whole fatuous process has to be kept going.

(5) When the prosperity achieved by inflationary means happens to be accompanied by thrift, economic growth will occur, although in a less productive form than non-inflationary growth; and the easily won and largely illusory development tempo then gives rise to a confusion of growth with rising prices, a confusion which politicians (not surprisingly) encourage. But growth is purely a matter of thrift. Rising prices are *not* a condition for growth. On the contrary, there are good reasons for regarding inflation as, on balance, a discouragement of growth. In countless ways, rising prices tend to induce consumption. In particular, the "money illusion" all too easily causes insufficient provision to be made for depreciation and the maintenance of "real capital" intact.

(6) The result of trying continuously to coordinate by inflation is that the basic causes of the disorder so crudely rectified are never tackled. For this reason, inflation is a more insidious and virulent manifestation of the disease of discoordination than unemployment and recession; for the latter, being more painful, creates incentives for fundamental reform.

(7) The origin of the most serious discoordinations of the modern economic system lies ultimately in the corrupting in-

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fluence of a tradition whereby governments have come to be regarded as beneficent distributors of favors to the people, the people in turn rewarding governments by keeping them in power. This tradition creates a situation in which governments can intimidate minorities (unless the minorities happen to be able to disturb the balance of political power). Business managements become disheartened and obsequious; and because inflation seems to offer the only way out, they acquire the habit of acquiescence in it. At the same time politically powerful groups or institutions are given virtual carte blanche to pursue purely sectionalist objectives. That is why the private use of coercive power – the most obvious cause of discoordination in the pricing mechanism – has come to be tolerated.

(8) The crucial task, yet the most difficult task, of a truly planned regime is to secure coordination without inflation; and that means, in the first place, protection of the community from such sectionist actions – particularly on the part of trade unions – as are calculated to reduce the flow of wages and other forms of income and render its distribution less equitable. A reduced flow of uninflated wages is always the consequence of any forcing up of wage rates (and hence product prices) in certain sectors otherwise than through free market pressures. If governments were aiming at (i) the maximization of the wage-flow, and (ii) equality of opportunity as a determinant of the distribution of wages, they would be *ipso facto* achieving effective coordination, for both rising prices *and* unemployment would then be simultaneously eliminated. But to achieve this result they would be forced to take the initially unpopular step of enshrining the right of all, and particularly of the poorer classes or races, to keep the price of their labor at a minimum. For instance, if equality of opportunity, distributive justice, and economic efficiency had been primary objectives in the United States, the minimum wage laws, which have slowed down the industrial progress of Blacks in the underdeveloped South, would never have been passed.

For identical reasons, governments would have to prevent other forms of contrived scarcity. A good example is the price supports which have become common where governments have been directly active in agricultural marketing. When the prices of primary products and food are raised, people have less uninflated income to spend on other things; and if the prices of

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these other things are rigid, that must mean the unemployment of some of the productive factors which manufacture them also. Dynamic forces cause cumulative contraction.

(9) The technique of inflation demands that governments and their agencies shall continuously deceive the public about the fact, the speed, and the duration of inflation intended. Ministers of Finance have here no option but to employ what has been called the "necessary untruth." Unless they do employ this technique, inflation will lead to costs rising as rapidly as prices, or in advance of prices, thereby, destroying the whole purpose of inflation. Moreover, yields on fixed interest bonds will be forced up and yields on equities forced down. As Professor Ludwig von Mises has insisted:

> These enthusiasts [for inflation] do not see that the working of inflation is conditioned by the ignorance of the public and that inflation ceases to work as soon as the many become aware of its effects upon the monetary unit's purchasing power....This ignorance of the public is the indispensable basis of inflationary policy....The main problem of an inflationary policy is how to stop it before the masses have seen through their rulers' artifices.(1)

The phrase "necessary untruth" was used in 1949 by the *Manchester Guardian*(2) in justifying the conduct of the British Chancellor of the Exchequer, Sir Stafford Cripps, who, just before the British devaluation of that year, and after it had been finally planned, had categorically denied on no fewer than nine occasions that it was intended. The British Government had secretly discussed the proposed step for some time, almost inevitably setting into circulation rumors of what was contemplated. They had finally decided to devalue, it seems, at least three weeks before they were ready to put their decision into effect. They had to discuss it first with the United States, Canada, and the International Monetary Fund. In the meantime it became imperative to mislead the trustful for the benefit of the mistrustful.

It had for some time been governmental technique to pretend, in order to dissuade rational reactions, that "suspensions" of convertibility were merely temporary breaches of obligation. Thus, in 1931 there occured one of the most disturbing examples of the necessity to mislead in order successfully to reduce the value of a nation's currency: Dr. Vissering, head of the

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Netherlands Bank, telephoned Mr. Montague Norman, Governor of the Bank of England. He inquired whether his bank would be justified in retaining the sterling it was holding. Dr. Vissering received from Norman an unqualified assurance that Britain would remain on the gold standard. He believed what he was told. In consequence, his bank lost the whole of its capital; for the very next day Britain abandoned gold. Through the same act, the Bank of France lost seven times its capital.(3)

Two years later, using the argument that he wanted "to control inflation," President Roosevelt persuaded Congress to give him extraordinary discretionary powers in the monetary field. Then, in April of that year, he decided to call in all privately owned gold "as a temporary measure." There was no suggestion that the real purpose was a forced depreciation of the dollar in terms of gold, the issue of an enormous number of notes, with open market operations by the Treasury and Federal Reserve System to acquire government securities and hence perpetuate the depreciation.

The fact that the Bank of France had been called upon to falsify its balance sheet in 1925, in order to maintain confidence, had been regarded as a shocking incident by those who understood what had happened.(4) But exactly the same kind of deception is inevitable if inflation is ever to be continuously successful. A delightful euphemism is "creating a favorable climate of opinion!"

Because a policy of creeping inflation must rely upon persistent deception, its survival in the modern world is obvious evidence of the corruption of government and of the disintegration of trustworthy relations between governments.

(10) The disintegration of faith in money (ultimately, of faith in government) has involved the peoples of the world in formidable material costs.

(11) The only way in which the general public can discourage inflation is to make it unprofitable. They can do this when they are in a position to insist upon fixed income contracts being revised ahead of instead of following the price increases at which official policy is aiming (perhaps via "escalator clauses"), and refusing to accept the dishonest assurance that their insistence can be a cause of inflation. A similar discouragement is effected when investors learn to avoid fixed interest bonds, ex-

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cept at very high yields to compensate for monetary depreciation.

(12) When more and more people begin to understand what is happening, a government which wishes to persevere with inflation is forced to take authoritarian action. It has to discourage or prevent those who understand from using market institutions to escape the destruction of the real value of their savings. In other words, when enlightenment spreads, for a government to engineer rising prices successfully demands eventual resort to price controls, rent controls, import controls, exchange controls, controls of capital issues, "income policies," and so forth. In the absence of inflation, all controls of this kind (or extra-legal "persuasions" with the same object, backed by arbitrary state power) have no purpose.

To what general conclusion are we led after consideration of these twelve points? Is it not that the gradual drift of the so-called "free world" towards a totalitarian concentration of power has had its origin in the creeping inflation which, dating from the 1930's, seems to have been mainly inspired by Keynesian teachings? Through public acquiescence in perpetually rising prices, we are threatened with an emergence of the sort of social order which, less than four decades ago, the blood of countless patriots was spilled to prevent.

In recording these thoughts, is the writer the victim of a futile nostalgia – a naive longing for the nineteenth century era? Has not inflation perhaps been an inevitable step towards a slow, inexorable transfer of consumer freedom (and the entrepreneurial freedom which is its consequence) to the state? Certainly there are those who, with a dogmatism of Marxian stubbornness, will argue that, once the institutions of representative government had been conceded, politicians were bound, sooner or later, to discover the potentialities of twentieth century techniques of persuasion and propaganda; whilst that discovery could not fail to mean the ultimate passing of authority to those most skilled, or most uninhibited, in controlling the minds and purchasing the support of political majorities. If they are right, the stereotype of the state as the donor of benefits was predestined to emerge, recourse to inflation had necessarily to follow; and as the community began to be more difficult to deceive, and started to use the remnants of the free market economy to evade the burden of inflation, the urge to totalitarian government became irresistible.

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Post-Script

The above twelve points did not attempt to deal with all the phenomena that inflation makes possible.*

Among these phenomena, that of the effect of inflation upon the volume of private debt is very important today. In the absence of inadvertent or deliberate inflation, pressures from relatively high interest rates limit private borrowing. Interest rates ration the scarce resources needed for replacement and growth so as to ensure, as far as possible, that it is the most productive activities which obtain the resources. The term "most productive" covers, of course, the most urgent activities. But once the dilution of capital through low, inflationary interest rates is resorted to, instead of monetary policy disciplining borrowers, it encourages, on an enormous scale, policies of "buy now, pay later."

My only criticism of William Simon's vitally important book, *A Time for Truth*,† is that he treats the process under which an almost fantastic structure of private indebtedness has come into being in the United States, especially during the last decade, as causing an *addition* to inflationary forces. In fact it is *a particular form* in which inflation occurs. He says that "on all levels of society, citizens borrowed in imitation of their government." But, given an inflation, borrowing is a profitable and economic way of using resources. Under a non-inflationary regime, interest rates, indirectly set by the Fed., would have caused borrowing to be too expensive for the less productive ventures, i.e., those having relatively low prospective yields. The menacing volume of debt, which should scare us all, could then never have accumulated.

One further point needs to be made. Because of the absurdity of government trying to deny responsibility for inflation and calling upon the people and the business community to "fight inflation," the custom has grown up of calling a wide range of non-monetary conduct by the adjective "inflationary." The idea is that everybody is in a position to act in an inflationary way and they are exhorted not to.

When government's advisors (in order to disclaim responsibility for debasement of the country's money unit) begin to use the term "inflationary" for all private or governmental acts which tend to slow down the rate of growth of aggregate output, they are misleading the country – inadvertently or pur-

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posely. They are drawing attention away from the fundamental evil, that is, the pricing of labor or the services of assets above market-clearing values, which has a cumulative depressive effect.

That was, we are inclined to think, the real intention of President Ford's advisors when they persuaded him to announce and support the ridiculous "WIN" campaign ("Whip Inflation Now"). Inflation occurs only when the aggregate value of money measured in terms of actual money units (such as the dollar) increases more rapidly than the demand for money, which is normally correlated with real income. There is no other cause. There is only one way in which the general public can inflate, and that is by committing the crime of forgery. Even economists sometimes refer to "inflationary acts" when they really mean acts which cause demand for money to fall. But it is in just that situation that central bank action is called for to reduce, or curb the rate of increase in, the nominal money supply.

Any discoordination in the pricing system which slows down the rate of increase in aggregate output will if there is no monetary response, be inflationary. In other words, all waste can be *called* inflationary, although what is meant (or *should* be meant, if we are thinking clearly) is that the rate of increase in the money stock is increasing faster than the rate of increase in the flow of outputs.

(1) L. von Mises, *The Theory of Money and Credit* (New Haven, Conn.: Yale University Press, 1953), pp. 418-19.

(2) September 21, 1949.

(3) B.M. Anderson, *Economics and the Public Welfare* (New York: Van Nostrand, 1949), p. 246; also, W.A. Morton, *British Finance, 1930-1940* (Madison, Wis.: University of Wisconsin Press, 1943) p. 46.

(4) B.M. Anderson, *op. cit., pp. 154-56. Anderson refers to the* Commercial and Financial Chronicle *(New York), April 11, 1925.*

* These phenomena were discussed in my *Keynesianism – Retrospect and Prospect,* 1963 (Regnery), and will be more fully dealt with in a forthcoming book in the press, *The Keynesian Episode – A Reassessment* (Liberty Press).

† Simon's description of the manner in which deliberate inflation is largely expressed in the form of a vast multiplication of private debt is brilliant. His exciting book is, indeed, the most important critique of contemporary economic policy in the United States that I, after more than half a century of academic life, have ever read.

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THE LIBERAL MIND

By H. W. J. Edwards

The word "liberal" has a different meaning in the Old World from that which it carries in the Americas. In American-English it seems to suggest almost any tendency towards the Left block in politics and may even be used to refer to those who are sympathetic to socialism and communism. In Britain, however, it is more subtle. The English liberal opposes socialism and communism, yet sees his chief enemy in the conservative – or what was traditionally known in England as the "Tory." A quick glance at the Tory philosophy will therefore provide us with an immediate key to the English liberal mind.

The "Tory" Antithesis

In a lecture given to the Sorbonne just before the Second World War, Mr. G. M. Young described Toryism as "the politics of national historic attitude." Although Burke was a Whig, when he came to write his *Reflections on the French Revolution* he began to express in noble English the essential Tory idea that custom and historic attitude are fundamental forces in the evolution of societies. This was also the view taken by Disraeli who stated that "a nation is a work of art and of time." By contrast, the spirit of liberalism has been appropriately portrayed by the French author, de Maistre, who wrote: "The philosophers had claimed that a man's naturally good urges had been vitiated by the false teaching concerning man's evil nature; vested interests and tyrannical ambitions found in that theory a justification for policies of oppression and exploitation. The result was that the suppressed good impulses turned to channels of perversion. Repression bred poison and evil which gave a further handle to usurping educators and law-givers. And so the chain of degeneration became more complex until society became a den of robbers and life a vale of tears. Give freedom to the natural instincts. Lift oppression. Once released, the people will form themselves into a harmonious pattern. Liberty will breed virtue." In this paragraph de Maistre summarized the very essence of the liberal mind, which sees society as the spontaneous product of free individuals rather than as a delicate

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fabric nurtured by time.

The liberal mind does not accept Marxist concepts of class warfare. Instead it is based upon a middle class bloc which has proved its power, even its dominance, without the use of arms, a class which has come to regard war as inimical to itself and its functions. And so we find a noted liberal, the Quaker pacifist, John Bright, declaiming against a war because "it had ruined the carpet trade."

Historical Background

At first the liberal mind tended to think of society as at best the sum total of individuals. The philosophic Tory, Coleridge, in his *Table Talk* related a conversation he had with that blue-stocking radical, Harriet Martineau, when he asked whether that was her concept of society. "Of course it is," she answered. But to Coleridge, man-in-society was much more. Mr. G. M. Young, commenting upon that conversation (vide his preface to my *The Radical Tory*, Cape, 1937), wrote: "That is what the Tory cannot be brought to see, because to him the ultimate elements in society, and therefore the medium through which statecraft has to work, are not individuals and not the sum of individuals statistically aggregated but the real relationships connecting them with each other, the product of these relationships being the nation. And these relationships, elaborated under the pressure of circumstances and molded by men's reflections upon them, create the institutions and orders of the State." For many years this individualism was the chief mark of the liberal mind, especially as that was reflected in liberal "laissez-faire" and in the writings both of Emerson and Samuel Smiles' *Self Help*, which had a huge circulation in the 19th century. To the liberal mind at that time, it was necessary only that a poor man save a small sum of money, enough to buy, let us say, a hand-cart on which to sell vegetables; so that he might buy a shop and then two, three or four shops, till he became a rich man. Such was the early liberal philosophy.

In terms of English politics the change came through one of those quirks of history which someone like Pascal liked to mention. A man named Chaplin went to the continent to study Bismarck's new German welfare state at the close of the 19th century. He returned very impressed and contrived to persuade the then Conservative government to set up a commission over

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which he presided. It reported just before 1906 when the Liberal Party won a landslide victory and when the so-called Labour Representation Committee put up candidates then called "Lib-Labs" of whom some 50 were returned. Egged on by these and by the report of the commission the Liberal government decided to start the welfare state in a modest way by granting state old age pensions. There was a minor revolt by strict Liberals, led by that politically eccentric Liberal, the ultra-dogmatic Catholic Hilaire Belloc. In his *Servile State*, Belloc warned his readers that this was the beginning of a prussianised and regimented order in which no one would be "liber legalis homo" but either one of a new manager class or fundamentally a slave ("a slave is one who lacks productive private property" was his quotation from, I believe, Aristotle).

Slowly the liberal mind came to terms with the collectivist, utopian summa of the Left. This process was encouraged by that little band of pilgrims, the Fabian Society, which at first was a congeries of philanthropic liberals and mild socialists. Its method is suggested by its title: its policy was to organize and construct by social reform with an eye to a distant Utopia. Its fundamental difference from traditional liberalism was the it saw society not as merely the sum total of individuals, but as the product of deliberate social engineering. It could not even understand the anti-liberal, the traditionalist or Tory (in the archaic sense) who believed that to be authentic the institutions of a nation grow through time. The new liberals believed such institutions could be made – that they could be built on a *tabula rasa* if necessary. Nothing so well exemplifies the dissidence of the Tory and the Liberal minds as the shrill acerbity with which the Liberal denounced the Tory way of thinking. If you could atomize a nation into its component parts, you might no doubt furnish it with institutions satisfying to the most austere rationalist (and the rationalist is generally of a liberal mind). But you can not do that, the Tories claimed, if only because the roots of all social relationships and therefore of all genuine political institutions are out of our reach. You cannot successfully disfranchise the dead of a nation; and so long as a nation is, and feels itself to be, a living organism, its ancestry is as much a part of its being as its posterity.

Karl Marx had enough insight to see that he had to contend not only with the laissez-faire bourgeoisie but with those he

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called in the appendix to the 1848 Manifesto "clerical or feudal socialists": "at times by their bitter and witty criticism striking the bourgeoisie to the very heart's core." He had in mind not only certain very orthodox clerics, mostly of the Roman church, who denounced the middle class "new rich", but a galaxy of counter-revolutionary writers including de Maistre, Bonald, Ballanche, the Schlegels, Coleridge, Southey, Newman, Disraeli, Haller and Novalis, all of whom in some way emphasized the collectivity of society. A modern conservative writer, both politically and theologically, H. Blamires, in his book, *The Faith and Modern Error*, has made very much of this collective background in the matter of what we call the mother-tongue. A child starts to speak not by some creative act but by listening. He receives words and thereby understanding, ideas and sentiments. In comparison with the accumulated cultural capital of many generations the little candle of the individual, however gifted, is of very small account. Language is not a conscious achievement of men deliberating but the result of an unconscious, collective effort. No one sets out to compose a real language. It comes into existence while generations live out lives full of distractions, slovenliness, and vagueness. Yet the outcome is a masterpiece of orderly cohesion. No wonder that that extreme counter-revolutionary, Bonald, wrote: "It is time to stop talking of *moi* and to direct our attention to *nous*. . . . Man's movements are imprinted on him by the whole of which he forms a part (Bourget pp 3, 6, 9)."

Bonald concludes from this that on the political plane far from men constituting society, it is society that constitutes men and forms certain groups of them into a nation. "La societé est la vraie et même la seule nature de l'homme (*ibid*)." The opponent of the liberal mentality considers that society is held together not by a deliberating reason – that reason which is essentially ratiocinative – and a resolve that democracy, a word of many meanings, demands that, after all, a voter is his own legislator (thus the cry for many referenda) but, in the language of Burke, by the massive sentiments passed on from generation to generation. To the liberal mind such sentiments are the forces of habit and inertia, fears begotten by taboos and mechanical reactions fostered by associations of ideas, and a great recoil from anything novel which tends to break up habits, so causing discomfort. The liberal must be answered. We have in mind sen-

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timents of awe, devotion, affection, chivalrous loyalty, and finally *prejudice*. This last in the sense intended is not a malicious or unworthy determination to prejudge a matter which needs a judicial attitude but the distillation of collective thinking of many generations. It constitutes almost instinctive reflexes generated by recurrent situations, similar stimuli and abiding realities. What may be called common courtesy or good manners is simply a form of this "prejudice," which is the basic requirement of civilization. Were one to stop every time one had to make any of the many common decisions during an ordinary day in order to make the whole calculus of the first principles and the general reasons in reference to the immediate situation, one's day to day life would be broken into fragments and one would be constantly oscillating and fumbling.

The ally of this "prejudice" is dogma. Mr. Ronald Knox pointed out that among the English and the English diaspora there is a curious dislike of words which contain the "og" sound, though this is partly accounted for by the coincidence that many such words have a slightly derogatory meaning such as fog, bog, cog (when used metaphorically as in someone's being a cog in a wheel), hog (in some part of England and in the metaphorical sense) and Wog (pejorative for a Levantine). Mr. Knox wrote this in order to show that the liberal mind objects to dogma partly because the sound itself is felt by the liberal to be objectionable. Dogma means in the proper sense no more than a widely held teaching, and comes from the Greek *dokeo*. The liberal mind – and this is what indeed I must soon come to – is quite unaware that it also holds certain dogmas with a tenacity of excessive zeal.

Dogmas are, usually, beliefs, values and frames of mind into which we are born. They are the setting as well as the stuff of our lives. Take them away and we are adrift unless we have other dogmas. Descartes erred when he asserted that we should start by saying we should doubt everything. The babe begins by believing long before he can speak to say so. On the other hand the theoreticalism of the liberal mind, if carried out, is anarchical and, strange to say, self-destroying. Society comes from cohesion and consensus. I do not write concerning such sciences which allow the scientist to pursue such abstract subjects which have nothing in themselves to do with man in society. The great difficulty for the psychiatrist or sociologist

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or the demographer or the anthropologist or the philanthropist is that he is acting as a man vis-a-vis his own kind. If he is aware of this, well and good. My years as a child until I was twenty-eight were passed as a birth-right Quaker, a member of an illustrious religious society which has excelled in spite of its few numbers in acts of philanthropy e.g. prison reform, that extraordinary "Underground Railway" led by Levi Coffin in the United States whereby slaves were smuggled from the Confederate States northwards, aid to countries in dire distress, and almost any kind of "social service" you may name. But it was this very zeal which tended to make me doubt the Quaker sanctions. I found that the Quakers who seem to possess the liberal mind *à l'outrance* regarded themselves as US and the people they proposed to help as *them*.. They did not see themselves as human beings in the same zoo as other human beings they intended to help. I do not charge them with vanity and certainly not that deadly sin of pride, but they did regard themselves as a kind of natural elite who had the good fortune to be able to help other people by reason of their own Quaker doctrines, which, if you examine them, are the very bee-bread of the liberal mind. The liberal mind always and necessarily is fascinated in its philanthropic effort by what is called "the deserving case." But what is that ? If Hitler were right, then the deserving case was the Nordic. A non-deserving case would be a gentleman from the Yoruba tribe of southern Nigeria. My experience among the Quakers was that many "deserving cases" were found after the First World War among the leftist intelligentsia of Vienna.

Selective Judgement

We come at this point to a curious aspect of the liberal mind: its remarkable capacity for a selective judgement largely based upon sentiment and the paradoxical circumstance that the liberal mind has its own dogmas and tradition. We can see this in the facile decision of the World Council of Churches, which is dominated by liberally-minded people, to supply African guerrillas with funds regardless of their brutality. In some way the liberal mind is able to filter facts through its conscience in order to justify what it does. One sees much the same attitude among those liberally-minded people who read liberal periodicals such as the (British) *New Statesman* which

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has supported Basque terrorist assassins while condemning Welsh Nationalist "extremists" for disrupting auction sales of rural Welsh cottages, much needed by local Welsh farm workers, which are bought as holiday homes by more wealthy Englishmen at prices the local farming folk cannot afford — even though these cottages had been the homes of their ancestors through generations.

Liberals, Myth and Dogma

For many years I have contended with the liberal mind, only to discover that, after all, I am to some extent caught in my own devices. For the liberal mind has, as I have earlier hinted, its own dogmas, even though it denies having dogmas. It also possesses a tradition even though it is one essentially of a near-past which the liberal has quite arbitrarily decided is "the past."

We have, then, the paradox that in many parts of the contemporary western world what passes as the "traditional" thought is really liberal thought. The genuine traditionalist whose attitude I have tried to describe is regarded either with horror or as a "reactionary," a word constantly in use by the liberal when he is forced to a stand. It is permissible to ask a man's reaction when he is suddenly presented with some fact or assertion. It is a solecism to ask for his reaction when he has had time to "form an opinion" or when the assertion is one the questioner must know will not be unknown to the man he questions. For some strange semantic reason the "reactionary" is always someone who rebels against the liberal mind and its works. We find, then, that any revolt by any genuine conservative forces is assumed by the liberal mind to be not only unfortunate but actually sinful (even though the liberal mind increasingly denies the existence of sin). By some means the liberal mind is able to allow all manner of evil deeds done by rebels of the so-called Left. There is, of course, one solution which was given us by two such different men as Cardinal Newman and the French syndicalist, Georges Sorel: the myth.

The myth in the sense they used it amounts to a quasi-factual account which is the result of a mass of information which so percolates through the mind which has already been prepared that a final answer is given. "Even if Churchill did not send the hussars to quell the Tonypandy riots, he did, so there," said an anthracite miner when I was speaking on a street square in a

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west Glamorgan village. *There* is the revolutionary myth which caused that miner so to speak, even by way of an antinomy (and not all antinomies are contradictions). Georges Sorel was quite open about in his *Reflections on Violence*, translated into English, by the way, by an English Tory, a young man named Hume. Newman described the formation of the myth in this sense in his *Grammar of Assent.* Thus the liberal mind was able to adjust reality to its own needs, as when –during the civil war in Spain – the then *Manchester Guardian* printed a passage referring to "the pacifist machine-gunners of Madrid."

The Liberal Dilemma

During the late fifties there entered into little England a stream which later was to become a mighty river of immigrants from Africa, the West Indies and Asia (relatively fewer entered Wales, Scotland and Ireland). Quite naturally increasing numbers of quite ordinary English people, many of whom had fought Nazism and Fascism and had no sympathy whatever with those political creeds, began to show their growing dislike of such unrestricted immigration. A Welshman of the diaspora led the opposition to such drastic ethnic changes – The Rt. Hon. Enoch Powell, then Conservative M.P. for Wolverhampton West in England's "Black Country." At once the massed liberal mind turned its collective typewriter upon him. His several speeches made by invitation were shouted down by "students." We had here an attempt by organized liberalism to produce a militant arm. Closely associated are such ad hoc bodies as the Council for Civil Liberties, and backing them for all intents was the Race Relations Board.

In recent times, however, the liberals have been confronted by numerous issues which present them with perplexing situations. How should they react to the claims for environmental conservation? When, just before World War II, Lord Lymington wrote his *Famine in England*, the liberals sneered at conservatives (conservationists) who opposed the destruction of the natural heritage, and spoke sneeringly of those they began to call "muck and mystical Tories." Yet most ordinary people were acutely aware of the social peril of various new engineering projects such as reservoir building, which meant the dispersal (as in Cwm Tryweryn) of an ancient "folk," for the industrial convenience of English conurbations. The replace-

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ment of indigeneous timber by conifer forests meant the extinction of animals and birds which needed the deciduous trees, new chemical works or power stations using uranium, meant pollution; and the construction of government-owned housing estates meant the disappearance of farming land. All this in the interest of supporting an increasingly overcrowded population growing primarily as a result of international immigration.

As a result of the activities of such "liberal" organizations I have frequently been obliged to defend the Welsh Language Society against charges of "racism." These absurd attacks on "racism" dominate the mind of the contemporary British liberal for good reasons. As we noted at the beginning of this article, the main driving force of the liberal is his opposition to the Tory concept of nations as discrete entities with their own distinctive being and reality. The concept of racial identity is itself a reflection of Tory thought in this respect, just as the innocent Welsh Language Society also reflects a belief in the reality of Welsh culture and of the Welsh nation. As such, both are bound to stir up the deep prejudices and antagonistic reflexes of the liberal soul.

The liberal mind is also not quite sure what to say about the troubles in that part of Ireland governed by London. It hedges. It recoils with pious horror at the terrorists of the provisional I.R.A. but to some extent the liberal mind is hoist with its own petard. It demands "self-determination" but it abhors nationalist sentiment, and when a people who regard themselves as a nation or as part of a nation ask for national self-determination they feel deeply disturbed. And so when there existed or was felt to exist what a Conservative prime minister (Macmillan) called "the wind of change" in Africa, "democracies" having an alleged independence and a bogus nationality were invented. The European liberals who sponsored these new political states were nevertheless careful to make sure that their boundaries did not reflect true ethnic or national boundaries, so that hardly any of these new African states possess the homogenity and unity of "true" nations, but are instead comprised of ill-assorted and frequently factious and warring amalgams of quite diverse ethnic nature.

The Catholic writer, Christopher Dawson, foresaw much of this but believed that nationalism would eventually triumph and

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overcome even forced attempts to produce a "Communist" or "Socialist" order. Tito is said to have written to Stalin:"You cannot ask me to prefer my politics to my patriotism." In spite of such agreements as the Warsaw Pact, the history of the countries east of the Iron Curtain has already shown that strict Communism, at least in the order of the history of the Marxist dialectic, has failed to suppress a national heritage. Poland is one example. Rumania is another. Although there has been an adventitious support by liberals for some upsurge of nationalism, e.g. Garibaldi's fight for a united Italy (at the expense of Savoy, a genuine nation as de Maistre pointed out), such support suddenly evaporates if, for example, international commerce is impaired or if the nation concerned is led by aristocrats, or reflects too deep-rooted an ethnic consciousness. Some liberals, notably Lord Morley, have admitted this and related aspects of liberalism. After listing the victories of liberalism he wrote: "The results of their fulfillment have been so disappointing as to make us wonder whether they are worthwhile (*On Compromises*; Macmillan)."

The liberal mind will undoubtedly remain with us. A kindly man or woman who abhors cruelty, the liberal shows great resilience even when liberal arguments are shown to be perilous or in some other way faulty. One of the reasons which gives us cause to believe that the liberal mind will persist is that, although the ordinary man may tell us again and again that like Enoch Powell he resents the great wave of aliens entering England, the liberal can ignore the ordinary man because he believes himself to be superior. The liberal likes to conceive of himself as "academic." He is a ready writer, and a steady reader of the sort of books everyone with a liberal mind should read. He likes to feel he is open to "new ideas," which are often very old ideas such as those about the rightness of sodomy and promiscuity; he is a devotee of a personalized future; he likes to be a patron of that fickle constituency, "youth"; he knows the media are easily open to him; he has gained a mastery over the use of emotive words like "racist" and "fascist"; he is confident that he is always in vogue (and uses vogue words to prove it); and he believes in Education (as opposed to education). Because of his belief in myth rather than reality, his opponent can never hope to convert him. All they can do is to point him out and expose the errors and contradictions of his logic.

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REDLINING IN HOUSING MARKETS: MORTGAGES AND MINORITIES IN THE U.S.

By James R. Barth
Joseph J. Cordes
Anthony M. J. Yezer

Government regulation of market transactions in pursuit of social objectives has become more prevalent in the United States in recent years. Financial markets are no exception to this trend. During the late 1960s and the 1970s, for example, several major regulations were enacted in response to a perceived failure of markets to provide "equal" access to credit. A number of these, particularly the Fair Housing, Home Mortgage Disclosure, and Community Reinvestment Acts, are intended to deal with the perceived social problems of "redlining."

Anti-redlining legislation raises several important issues concerning definition and detection. The main objective of this paper is to clarify several important issues that arise in defining and detecting redlining. The next section identifies and compares three different definitions of redlining corresponding to the views of economists, lawyers, and anti-redlining activists. These definitions share a common view of "redlining" as denial or limitation of mortgage credit by lenders based on property location. The economic, legal, and activists' views differ, however, in their judgment of the "social desirability" of particular credit limitations.

After discussing the various definitions of redlining, the statistical tests which are implied by each definition are considered. It is shown that whether any specific mortgage data indicate any factual or logical support for arguments in favor of government action depends directly on the initial definition of redlining which is adopted.

Definitions of Redlining

Redlining is traditionally associated with lender behavior that denies or limits mortgage credit to specific neighborhoods.

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However, under this broad rubric, at least three distinct definitions or redlining may be identified. These alternative definitions of redlining emphasize different standards of acceptable lender behavior. Concepts of redlining may be further distinguished by the relative importance accorded to the behavior of individual lenders as opposed to groups of lenders.

A. Criteria of Acceptable Lender Behavior

Three alternative standards of lender behavior may be identified based upon statements made by anti-redlining community activists, empirical economic research which has been conducted, and government anti-redlining regulations which have been passed. When referring to these definitions, they will be termed, respectively, as (1) the "social justice" definition, (2) the "economic" definition, and (3) the "legal" definition.

1. Redlining as a "Social Justice" Problem

Appeals to "social justice" are frequently found in anti-redlining statements. While the question as to whether it is "social justice" to deprive individuals and firms of the right to make independent and free decisions concerning their credit policies is not raised, the limiting or denying credit because of property location is represented as socially undesirable in that it supposedly contributes to greater inequality in the distribution of housing services." It is argues that areas which are allegedly redlined have relatively greater concentrations of low-income and/or minority residents. It is further assumed that the demographic composition of buyers is similar to that of sellers in "redlined" areas. These two assumptions imply that redlining by lenders effectively reduces the access of low-income and minority groups to owner-occupied housing. In addition, redlining is alleged to reduce the supply of "decent, affordable" housing by contributing to the deterioration in the housing stock of older neighborhoods located in central cities. These arguments suggest one definition of redlining as the differential treatment by mortgage lenders of neighborhoods which is harmful to low-income and/or minority groups.

2. Redlining as Economically Inefficient Lender Behavior

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Much of the empirical economic research in this area either implicitly or explicitly defines redlining as the differential treatment of neighborhoods by mortgage lenders for reasons other than differences in the costs and risks of making loans. Under this view, redlining occurs whenever lenders fail to make loans in certain neighborhoods that would be profitable at an acceptable level of risk. Presumably this behavior is due to lender misinformation and/or prejudice about the risks of lending in specific geographical areas.

Though redlining may imply non-profit maximizing and, hence, economically inefficient behavior by lenders, this type of behavior may be privately rational if lenders strive to maximize a broadly defined utility function that includes profit as just one of several arguments. This concept of redlining is analogous to models of discrimination in product and factory markets which assume that employers maximize a utility function consisting of ethnic and racial characteristics of employees as well as profits.

Consider first how redlining would be defined if there were no possibility of default or delinquency on the part of borrowers. Maximization of lender's utility would require that mortgage funds be allocated amoung properties so as to equalize utility per mortgage loan. Neighborhood characteristics may affect lender utility in two distinct ways. First, property location would affect utility indirectly by affecting profits. For example, the costs of processing and servicing loans might vary spatially because of scale economies to lending in certain areas.(1) Lenders would, *ceteris paribus*, earn relatively high profits in neighborhoods requiring relatively low processing and service costs. Utility maximization by lenders would favor such neighborhoods. However, in such cases, *utility maximization* would be equivalent to *profit maximization*. No redlining would be present in the economic sense of the term.

Second, property location could affect lender's utility directly. Presumably, such effects would be due to lenders' subjective attitudes toward lending in different neighborhoods. Utility maximization by lenders would cause them to "value" loans made on some properties more highly than loans on others solely because of neighborhood location. In these cases, utility maximization would not be equivalent to profit maximization and redlining of some form would be present.

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The analysis is complicated somewhat by introducing uncertainty about the repayment of mortgage loans. If such uncertainty were present, revenue would be a random variable whose value would depend on the terms of the loan (particularly owner's equity), property characteristics, borrower attributes, and location of the property. Neighborhood characteristics also affect lender utility through their impact on expected revenue. It is quite plausible to expect default probabilities and, hence, expected default losses to vary systematically by neighborhood. Other things equal, expectd profits would be relatively high in neighborhoods with relatively low expected default losses. Lender behavior that favored such neighborhoods through more lenient credit terms would not be viewed as redlining because maximization of expected utility would be tantamount to maximization of expected profits.

Redlining would occur in two ways when uncertainty is present. First, redlining would occur if property location affected lender's utility directly. Second, redlining would occur if lenders made use of "systematically biased" information in assessing the impact of neighborhood on expected revenue. For example, appraisers might systematically undervalue property in some locations because of class and/or racial composition. In such a situation, the differential treatment of borrowers on the basis of neighborhood would result in the maximization of a biased measure of profits. Unless lender's willingly cooperate, the profit incentive should eliminate any reliance upon inaccurate or biased information. However, it may take time for this type of inefficiency to be eliminated by the dissemination of accurate information.

Thus, redlining, in the economic sense, occurs whenever utilility maximization of lenders if not consistent with maximization of an unbiased measure of profits. However, if lenders are assumed to be risk averse, the link between redlining and non-profit maximizing behavior is broken Risk-averse lenders forego the single goal of the maximization of expected profits because of their concern with "risk." Other things equal, lenders would favor "low risk" relative to "high risk" neighborhoods. In this case, lender behavior would lead to the maximization of expected utility, but not necessarily expected profits. However, if aversion to risk were viewed as a "permissible" preference, differential treatment of loans based on location

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would not be considered as redlining, provided that differential treatment corresponded to differences in risk.

3. Redlining as Legally Prohibited or Discouraged Lender Behavior

Lender behavior which is either prohibited or discouraged by government regulation comprises the legal definition of redlining. The legal approach to defining redlining is illustrated by lists of criteria, set forth in the Fair Housing (1968) and Community Reinvestment Acts (1977), that lenders may and may not use in evaluating mortgage applications. Permissible characteristics include:

(1) the condition or design of the proposed security proerty, or of nearby properties which clearly affect the value of that property,
(2) the availability of neighborhood amenities or city services; and
(3) the need of the bank to hold a balanced real estate portfolio, with a reasonable distribution of loans in various neighborhoods, types of property, and loan amounts.

However, lenders are enjointed from:

(1) denying or resticting mortgage credit in certain neighborhoods in the lender's service area because of race, color, religion, age, marital status, or national origin of the residents;
(2) relying on appraisals that assign a lower value to a neighborhood because of a mix of races and national origins;
(3) equating a racially mixed neighborhood with a deteriorating neighborhood;
(4) incorporating the idea that detrioration of a neighborhood is inevitable;
(5) equating age of the property with the value of the property; or
(6) pre-screening of loan applicants.

Three recent trends in regulatory policy may broaden the legal definition of lending. The first is discouraging lenders from taking into account property characteristics which are correlated with objective determinants of default, but which do not

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themselves "cause" default. A second is admonishing lenders to pay special heed to the credit needs of low- and moderate-income neighborhoods. The third is treating as redlining "error of omission" that discourage potential borrowers from applying for loans. For example, under the Community Reinvestment Act lenders are also judged as to whether they make affirmative efforts to encourage applications for credit.

B. Firm vs. Market Redlining

Regardless of how "acceptable" lender behavior is defined, it is important to distinguish between *firm* redlining and *market* redlining. Firm redlining exists when some individual lenders redline certain neighborhoods. Market redlining would occur if all lenders behaved in this manner. In general, redlining at the firm level is a necessary but not a sufficient condition for market redlining.

The distinction between firm and market redlining is important from the standpoint of public policy. Firm redlining affects the terms of mortgages offered in different neighborhoods by some but not all lenders. In contrast, market redlining implies neighborhood variation in mortgage terms offered by all lenders. Thus, if a neighborhood is redlined only by some lenders, borrowers have the alternative of obtaining funds from "nondiscriminatory" lenders. The "costs" of firm redlining are the costs of searching for such alternatives borne by borrowers. By comparison, if a neighborhood is redlined by all lenders, such alternatives are not available. In addition market redlining may depress housing prices in the affected areas, so that the burdens of market redlining may be borne by both sellers and buyers.

C. Comparing Alternative Definitions of Redlining

A proper definition is the first step toward detecting redlining. As seen in Table 1, the term redlining can have as many as nine different meanings, depending on how one defines acceptable behavior as well as the relevant unit of analysis. There are several major differences among these definitions. Under the "social justice" definition, credit denial or limitation, though based on objective economic factors, would nevertheless be

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TABLE 1

ALTERNATIVE DEFINITIONS OF REDLINING

	Unit of Behavorial Analysis		
	Market	Individual Firm/Lender	
Standards of Acceptable Behavior	**Conventional and Government-Insured**	**Conventional Only**	**Coventional Only**
"Social Justice"	Differential treatment of neighborhoods by *conventional and government-insured* lenders as a group which is alleged to be harmful to the interests of "low-income" and/or minority groups.	Same as first column but focus limited to the *conventional mortgage* market.	Same as first column but focus limited to *individual lenders.*
"Economic Efficiency"	Differential treatment of neighborhoods by *conventional and government-insured* lenders as a group which is unjustified on the basis of risk, cost, and return conciderations.	Same as first column but focus limited to the *conventional mortgage* market.	Same as first column but focus limited to *individual lenders.*
"Legal"	Conventional and government-insured lenders as a group use prohibited or discouraged variables in evaluating applications and/or determinating loan terms.	Same as first column but focus limited to the *conventional mortgage* market.	Same as first column but focus limited to *individual lenders.*
	Conventional and government-insured lenders as a group use criteria that are correlated with but do not cause default and which have the effect of denying or limiting credit to protected categories.	Conventional and government-insured lenders as group fail to make affirmative efforts to provide mortgage credit in target areas.	

classified by activists as redlining if such actions impose relatively onerous terms on "deserving groups." This would definitely not be so under the economic definition. Whether such actions would be redlining in the legal sense is uncertain. Lenders are permitted to deny or modify credit applications provided certain "objective factors" are used. However, if such behavior had the effect of limiting credit to legally protected categories, such as minorities or low- and moderate-income areas, it would be viewed with suspicion.

The economic and legal concepts differ in their approach to defining redlining. The statutory definition presumes that certain property location attributes are not objective measures of cost and risk whereas the economic definition draws upon theory and empirical evidence to assess whether or not particular attributes are objective risk measures. These different approaches, however, need not produce conflicting results. For example, if a mortgage relied on lending criteria which were legally prohibited and which also were not systematically related to costs and risks of lending, redlining would occur in both the legal and economic sense. Lending decisions based on factors "correlated with" but not "causing" risk might, however, be viewed differently under the economic and legal definitions. That is, such decisions might be consistent with economic efficiency although prohibited under anti-redlining legislation.

The "social justice," "economic," and "legal" views of redlining also differ in their definition of the relevant credit market. Anti-redlining community activists have, for example, argued that government-insured mortgages are inferior substitutes for conventional loans. Indeed, some have argued that substantial FHA lending in a neighborhood is itself a sign of credit deprivation. Presumably, such persons would consider the "relevant" market to be limited to conventional mortgages. The economic definition of redlining, on the other hand, has been applied more broadly, having been used in studies of both government-insured and conventional mortgage activity. However, recent studies have tended to focus primarily on conventional loans. Finally, government anti-redlining regulations are written with reference to the practices of individual lenders rather than the entire market.

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Detecting Redlining

The various definitions of redlining summarized in Table 1 imply specific empirical tests. This section describes these tests and assesses their relevance for government regulatory policy directed at mortgage markets.

A. Detecting Redlining When Lender Behavior is "Socially Unjust"

Anti-redlining activists often cite higher rejection rates and/or more stringent mortgage terms in "low-income" neighborhoods as evidence of redlining. Indeed, such evidence was prominent in the testimony supporting current regulations to deal with redlining. There are two serious limitations of such studies. First, the data are typically based on the lending practices of only a subset of lenders. Consequently, such empirical findings pertain to lender but not market redlining. A second problem is the use of "neighborhood" as the unit of analysis. If the existence of redlining is to be considered inequitable or unfair, it must be because individuals and not neighborhoods are harmed.

To date, a careful study of the distributional effects of redlining has not been done. (2) However, even if it were, the results of such a study would have limited implications for *regulatory* policies. In particular, this would be the case if more stringent mortgage terms were justified by cost and risk considerations, but were faced by those least able to pay. In this instance, "redlining" would be the result of interactions between a *well-functioning* mortgage market and an unequal income distribution. It is arguable whether an issue of this sort can and should be dealt with by government regulation of mortgage lenders.

B. Detecting Redlining When Lender Behavior is Economically Inefficient

Economic analyses have attempted to test for the presence of redlining both *directly*, by examining neighborhood differences in mortgage acceptance/rejection rates, mortgage loan terms, and mortgage flows, and *indirectly*, by analyzing the impact of property location on default.

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B. 1. Detecting Lender Redlining

For simplicity, only the interaction between the behavior of *two* lenders and the mortgage markets in *two* neighborhoods, neighborhood A and neighborhood B, will be considered here. It is initially assumed that both lenders are equally able to make loans in both neighborhoods. It is further assumed that both neighborhoods are identical in all respects but one, racial composition. For sake of illustration, neighborhood B is assumed to have a higher proportion of racial minorities among its residents than neighborhood A.

Figures 1(a) and 1(b) depict the market in the absence of redlining by either lender. Lenders would treat mortgages written in either neighborhood A or B as perfect substitutes, and would, therefore, be prepared to supply credit along the schedule S. Since mortgage demands in both neighborhoods A and B are, by assumption, identical, both mortgage interest rates and dollar mortgage flows would be equal in both neighborhoods if redlining were absent.

Redlining of neighborhood B by one lender, but not both, is depicted in Figures 2(a) and 2(b). Lender 1 — the nonredlining lender — still views mortgages in both neighborhoods as perfect substitutes. However, lender 2 would require mortgage rates greater than i*, say i_2, in order to provide mortgage credit to neighborhood B.(3)

Figures 2(a) and 2(b) are a simple illustration of lender as opposed to market redlining. Several consequences of this form of redlining can be readily illustrated with the aid of these diagrams.(4) First, neigher the *total flow* of mortgage credit to neighborhood B is reduced nor is the mortgage interest rate increased by the discriminatory behavior of only lender 2. That is, firm redlining affects the composition but not the level or price of mortgage credit available to neighborhood B. There are, however, some observable consequences of lender 2's behavior. These include no loans granted by lender 2 in neighborhood B and lower application rates and/or higher rejection rates for mortgages offered by lender 2 in neighborhood B.

This simple model of redlining demonstrates that traditional harms associated with "redlining," such as more stringent interest rates and reduced credit flows, need not occur if redlining is practiced by some, but not all lenders. The model also suggests

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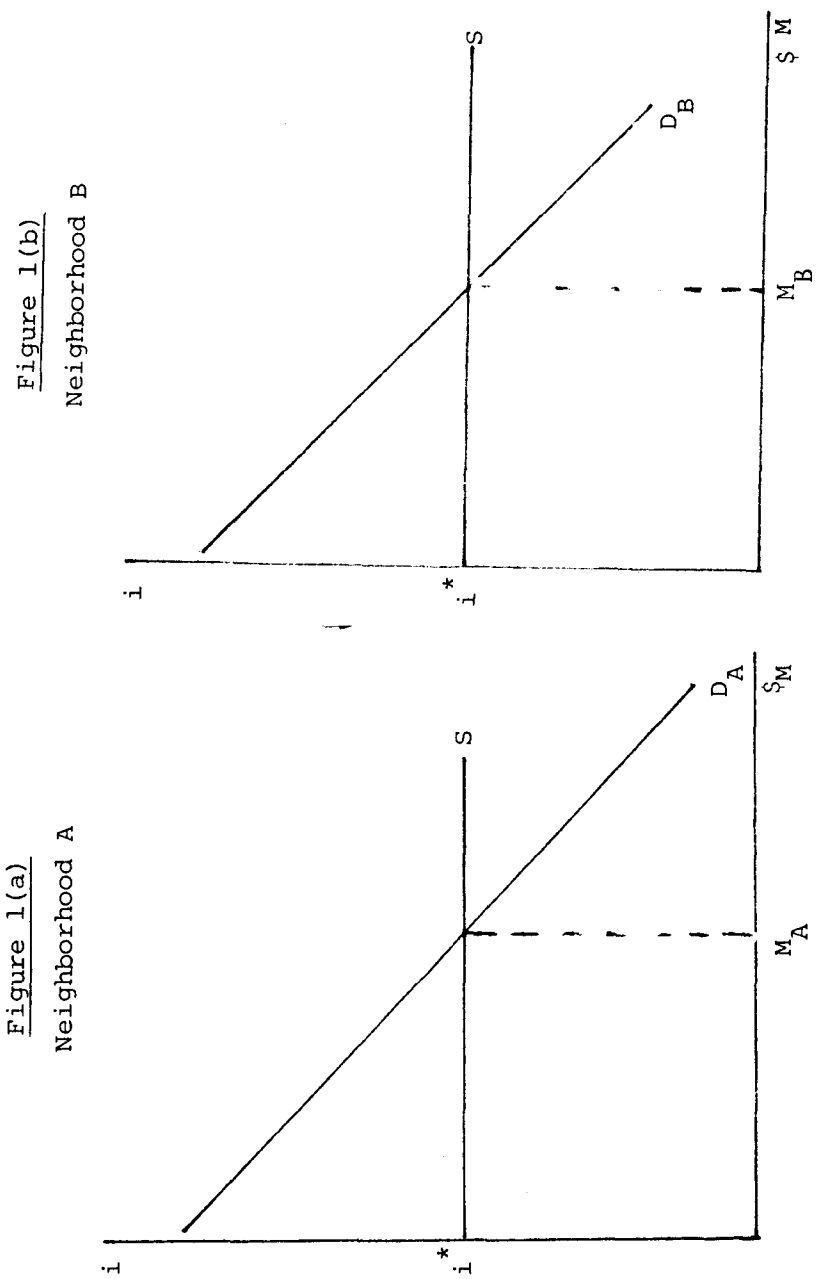

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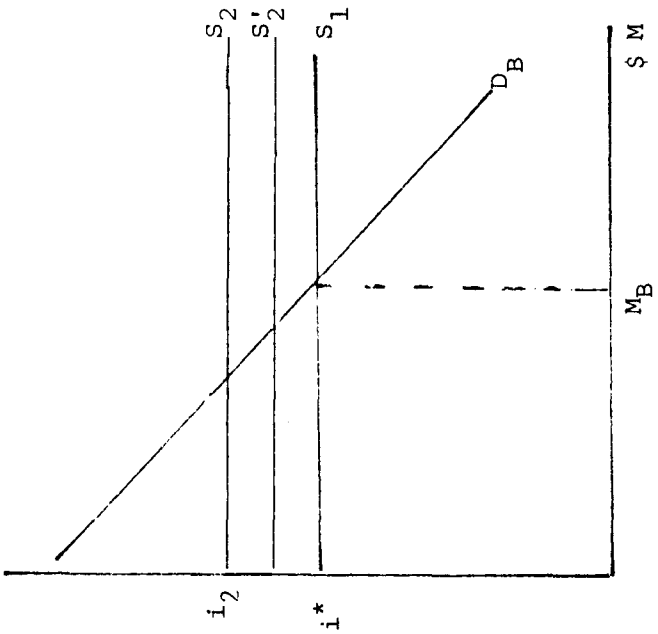

Figure 2(b)
Neighborhood B

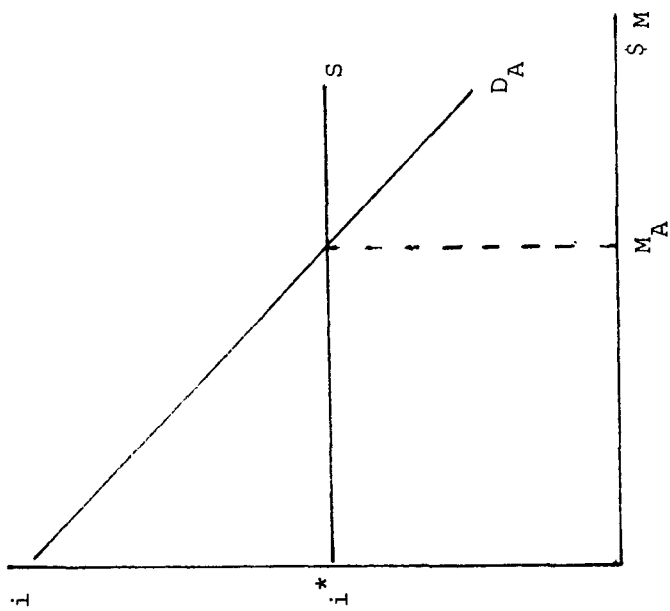

Figure 2(a)
Neighborhood A

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that anti-redlining regulations are unlikely to affect the terms and amount of mortgage credit extended in "redlined" areas if redlining is a lender rather than a market phenomenon. This is illustrated in Figure 2(b), where anti-redlining regulations are depicted by a downward shift in the redlining lender's supply curve from S_2 to S'_2. In this case, government regulation would not affect the price or amount of mortgage credit, even if the supply curve shifts downward all the way to S_1.

Detecting redlining by individual firms is still relevant for public policy. The simple redlining model implicitly assumes that discriminatory and nondiscriminatory lenders may be costlessly distinguished by borrowers. In practice, borrowers may have to engage in some amount of search to identify unbiased lenders. The necessity of search behavior has two consequences. First, borrowers must invest resources in order to search for those lenders who do not redline. Second, if borrowers were not completely successful at search, some would transact mortgages at prejudicially more stringent terms. Reducing the incidence of lender redlining would reduce the likelihood to both outcomes. Moreover, the presence of lender redlining is certainly a necessary condition for market redlining.

Disclosure requirements imposed on lenders in California, Massachusetts, and New York have produced data on individual loan terms along with borrower, property, and neighborhood characteristics. These data have been used to analyze allegations of redlining by Benston, Horsky, and Weingartner (1978), Schafer (1978), and Muth (1979). A common feature of all these studies is that they fail to examine the lending behavior of *all* mortgage lenders. Thus, they are tests of lender rather than market redlining. Moreover, all of these studies find that neighborhood and property location variables either have a marginal or no significant impact on mortgage terms. Such findings are consistent with our simple model in which some, but not all lenders redline.

Figure 2(b) suggests that lower application and/or rejection rates may be an observable consequence of lender redlining. Warner and Ingram (1979) and King (1979) have analyzed rejection rates at S/L's. Both studies fail to find a significant relationship between neighborhood location and rejections after controlling for objective economic factors. A major limitation of both studies is the low incidence of rejections – roughly a

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meager 6% of all applicants. Such a low rejection rate is unlikely to reveal sharp differentials in the treatment of borrowers based on neighborhood location. More importantly, such a low rejection rate is to be expected if either applicants are able to identify and avoid lenders who redline or lenders pre-screen applicants. In either case, rejection rates in the redlined area would not be discernibly higher, even though some lenders engaged in redlining.

Figure 2(b) also suggests lender redlining may be manifested in reduced mortgage flows between some lenders and redlined areas. Studies of the spatial distribution of mortgages contributed significantly to testimony in support of current regulations on redlining. Indeed, the Home Mortgage Disclosure Act (1975) requires that financial institutions make available data on the locations, by census tract, of mortgages made and held in their portfolios. There is, however, a general problem with existing analyses of mortgage flows. As noted by King (1979), in an excellent survey, both supply and demand determine the quantity of mortgage credit extended in a neighborhood. Single equation models of mortgage flows therefore describe a reduced form relationship between mortgage activity and neighborhood characteristics, rather than the supply behavior of lenders. If redlining is associate with differential supply behavior across neighborhoods, then the existing mortgage flow studies have little, if any, ability to identify markets in which redlining has occurred.

Detecting lender redlining is further complicated by lender specialization and risk aversion. That is, even if one had sufficient data to estimate lender supply curves such as S_1 and S_2 in Figure 2(b), such estimates would have to be interpreted with considerable caution. For example, with nonconstant returns to scale, mortgage terms depend on the number of mortgages written in a neighborhood. If mortgage demand is greater in area A than B, then some lenders would specialize by lending in area A. Alternately, if each lender makes the same ratio of mortgages in areas A and B and, given returns to scale, there will either be unexploited returns to scale in lending to area B (lenders on the falling portion of their average cost curve) or lenders in area A will be operating on the rising portion of their average cost curve. This type of situation makes it difficult to identify unwarranted *lender* price discrimination because firms

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specializing in area A will have more stringent terms for mortgages in area B than in area A, while their terms for area B will be stricter than those of other lenders who are lending in area B.

Risk-aversion also raises several difficulties with respect to economic definitions of redlining. If lenders are risk-averse, the detection of lender redlining requires that differential treatment of neighborhoods due to risk-aversion be distinguished from differential treatment due to prejudice. Since both risk-aversion and prejudice imply that lenders would not simply maximize expected profits, such distinctions may be difficult to make, unless one is able to measure "risk" across neighborhoods. Furthermore, one would need information about a lender's preference toward risk since different risk preference may explain why some lenders are willing to make loans in some areas, while others are not.(5)

Hence, direct tests of whether individual lenders redline are difficult to implement. Analyzing the impact of neighborhood characteristics on default experience of lenders, does not provide a direct test of whether redlining occurs. However, determining which neighborhood characteristics, if any, affect default, is essential for both detection and regulation of lender redlining. A common defense by lenders against allegations of redlining is that lending in certain neighborhoods is riskier than lending in other areas. Government regulations prohibit lenders from using certain neighborhood characteristics. Empirical studies of the spatial determinants of default should therefore provide evidence on both the validity of lenders' claims and the impact of various government regulations.

Single equation models of default experience on FHA-insured mortgages estimated by von Furstenberg (1969), and Jackson, Kasserman and Thompson (1979) have shown that default probability increases with the loan-to-value ratio and the term of a mortgage, in addition to being affected by borrower characteristics, particularly income, and by property attributes. A study done by von Furstenberg and Green (1974) of mortgage delinquencies (payment 40+ days in arrears) in the portfolio of a Pittsburgh savings and loan association indicates that loan terms and borrower income affect delinquency in a manner similar to default. Neighborhood racial composition, however, is significant only when age of the unit is omitted from the regression. Von Furstenberg and Green conclude that borrower

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and property characteristics dominate neighborhood location as determinants of delinquency on home mortgages.

Recent studies by Schafer (1978) and Barth, Cordes, and Yezer (1980a, B) examine the relationship between default and property location in great detail. Descriptive tabulations of Schafer's data from regulated lenders located in Buffalo, Rochester, New York, and Nassau-Suffolk, indicate substantial variation in foreclosure and delinquency rates across neighborhoods and lenders. However, differences in these rates were not systematically related to neighborhood income. More specifically, economic burden and equity variables often affected delinquency and default in ways anticipated by economic theory. However, neighborhood characteristics failed to exhibit a consistent and significant relationship to the probability of delinquency and serious delinquency.

Barth, Cordes and Yezer (1980a) (BCY) estimate both single and multi-equation models of default using data obtained from the 1975 Annual FHA-Master Statistical File (FHA-MSF). This data set contains information on FHA mortgage insurance written under various sections of the National Housing Act. This analysis is confined to transactions involving existing units under Section 203(b) because this particular program most resembles conventinal mortgage insurance activity in cities.

The results presented by BCY indicate that many, but not all, property and locational characteristics have a significant impact on foreclosure. From the standpoint of regulatory policy, these characteristics can be grouped into two categories: (1) those prohibited or discouraged by regulations, and (2) those permitted by regulations. Currently, lenders are proscribed from limiting mortgage credit due to age of the property and racial composition of the neighborhood. The BCY results indicate that neither prohibited attribute has a significant impact on default once other factors are taken into account. By contrast, the Fair Housing Act allows lenders to take into account both the structural condition of the property itself and the structural condition of nearby properties. BCY's results indicate these characteristics do significantly affect default rates.

B. 2. Detecting Market Redlining

Figures 3(a) and 3(b) depict the outcome when two lenders

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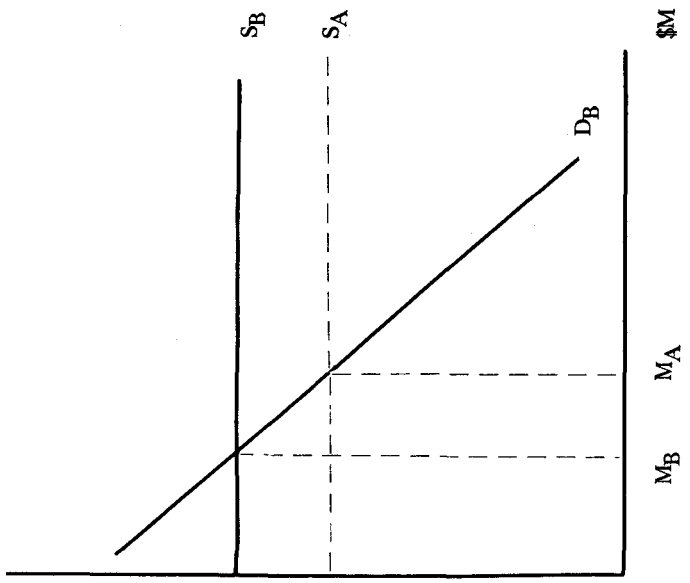

Figure 3(b)
Neighborhood B

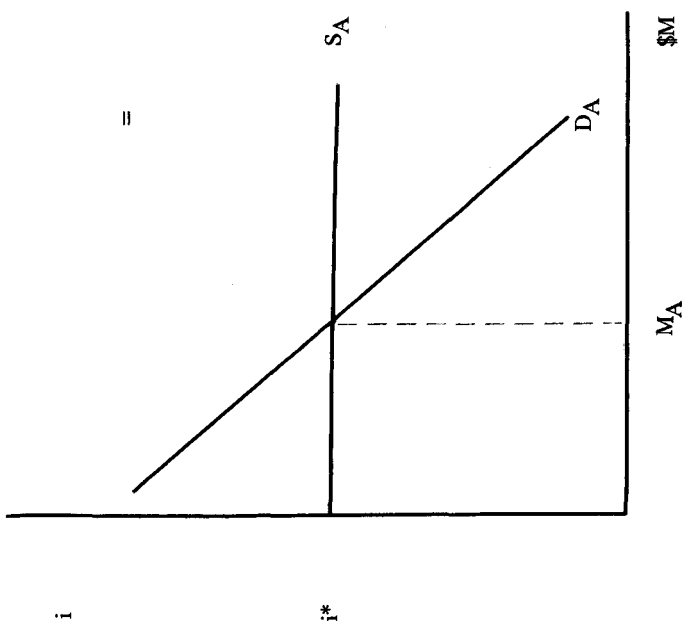

Figure 3(a)
Neighborhood A

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view mortgages in neighborhood B as inferior substitutes to mortgages in neighborhood A. In this case, both lenders require a mortgage interest rate in B which is higher than that in A. The initial outcome of market redlining is the one "traditionally" associated with redlining. That is, the interest rate on mortgages in neighborhood B rises to i_1, while the flow of mortgage credit falls to M_B.

However, these outcomes may only be first-round effects. Assuming that houses in both neighborhoods may be viewed as consols, which yield a fixed flow of housing services over time, the asset values of housing in neighborhoods A and B would be determined by equations (1) and (2).

$$(1)\ V_A = \frac{p_A h_A}{r_A} = \frac{N_A}{r_A}$$

$$(2)\ V_B = \frac{p_B h_B}{r_B} = \frac{N_B}{r_B}$$

where p_j is the rental price per unit of housing services in neighborhood j, h_j is the flow of housing services provided by a house in neighborhood j, and f_j is the cost of financing the purchase of housing in neighborhood j. N_j is the rental value per period of a house in neighborhood j.

Given that units in A and B are identical, $P_A = P_B$ and $h_A = h_B$. This implies that $N_A = N_B$, which in turn implies that the housing asset values V_A and V_B are uniquely determined by costs of financing housing purchases in each neighborhood. The cost of financing housing purchases, r_j, is a function of the mortgage interest rate i, the opportunity cost of equity, r_o, and the equity (loan)-to-value ratio.

If the increase in the mortgage interest rate due to market redlining causes r_B to rise, but does not in and of itself affect the net flow of housing servives, N_B, the asset value of houses in neighborhood B will decline. (For a more formal analysis of the impact of lender prejudice on r_B, an Appendix is available on request from the authors). This implies that those who purchased houses in B prior to redlining will suffer capital losses. More significantly, such households will experience an increase

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in their loan-to-value ratios, since V falls relative to the outstanding mortgage loan. Based on the equity theory of default, this latter event may trigger increased defaults in neighborhood B.

If defaults in neighborhood B increase in the manner described redlining would appear to be a self-fulfilling prophecy. That is lenders could point to greater defaults in B as evidence of greater risk even though such activity was caused by lender actions. For this reason, *time-series* observations on default rates in different neighborhoods may be unreliable indicators of whether lenders as a group are justified in treating some neighborhoods differently than others.

The increase in defaults which confirms lender expectations, should, however, be a temporary phenomenon. That is, there is no reason to expect default rates in B to permanently exceed those in the non-redlined area, A. Indeed, new migrants into B would have *lower* loan-to-value ratios than those persons leaving the area if the higher interest rates in B lead to greater downpayments. Thus, in the new "equilibrium with redlining" mortgages actually written in B would have lower loan-to-value ratios and the same or higher interest rates than those written in A.

In sum, market redlining would have several impacts. First, the burdens of such universal discrimination would be borne by both sellers and buyers in the redlined area. The presence of capital losses suffered by sellers in redlined areas might therefore be viewed as a sign of market redlining. However, without additional information, one cannot determine whether such capital losses are due to racial preferences or to directly economic factors.(6)

The adjustment of loan-to-value ratios by home purchasers in response to lender behavior may provide a basis for detecting market redlining. Specifically, such adjustments imply that direct tests of redlining based on comparisons across neighborhoods of loan terms or mortgage flows are relevant, provided that two conditions are fulfilled. All mortgage lenders must be included in the sample used for such comparisons and one must control for the impact of objective economic factors, such as income, wealth, etc., in both loan terms and mortgage flows.

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Summary and Conclusions

Government policies to discourage redlining have dealt with actions of lenders that deny or limit credit to specific neighborhoods. This broad conception of redlining, however, includes at least three distinct definitions of redlining. These alternative definitions differ in two important respects: the standard established for acceptable lender behavior, and the relative emphasis placed on the behavior of individual lenders rather than groups of lenders.

Three alternative standards of lender behavior are implied in statements made by anti-redlining activists, in empirical economic research on redlining, and in government anti-redlining regulations. These are termed, respectively, the "social justice," "economic," and "legal" definitions. A major difference among these definitions is the treatment of objective economic factors in evaluating lender behavior. Under the "social justice" definition, credit denial or limitation, though based on objective economic factors would nevertheless be classified as redlining provided such actions imposed relatively onorous terms on deserving groups. This would clearly not be so under the economic definition. The role of objective economic factors in legal definitions of redlining is more ambiguous. Lenders are permitted to deny or modify credit applications provided certain "objective factors" are used. However, if such actions had the effect of limiting credit to legally protected categories, or low- and moderate-income areas, they would be discouraged.

The various conceptions of redlining also define the relevant credit market differently. Anti-redlining community activists have tended to view government-insured mortgages as inferior substitutes for conventional loans and therefore consider the relevant market to be limited to conventional mortgages. The economic literature has dealt with both conventional and government-insured loans, though recent studies have focused primarily on conventional mortgage loans. Finally, government regulations are written with reference to the practices of individual lenders rather than groups of lenders.

Regardless of how redlining is defined, the burden of proof rests with those who allege that redlining is an undesirable and a widespread activity requiring government intervention into private transactions. The distinction between market and lender redlining is particularly relevant since the social harms alleged

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by anti-redlining activists occur only in the former instance. Existing economic analyses of neighborhood variation in loan terms are not capable of determining whether specific subsets of lenders engage in redlining. However, such studies are capable of determining whether redlining exists in the market as a whole, and to date, provide no evidence of such market redlining. There is, therefore, no evidence of any such market failure as anti-redlining regulations purport to remedy.

FOOTNOTES

(1) For a more detailed discussion of such factors, see Clapp (1979).

(2) It should be noted that socio-economic variables have been included in econometric analyses of rejection rates on mortgage applications. See Schafer (1978) and King (1979). The findings of such studies could, therefore, be used to examine the distributional impacts of lender behavior.

(3) It is interesting to note that "Many lenders will not make a mortgage loan until after FNMA has approved the loan for its purchase" [Federal National Mortgage Association (1979, p. 31)]. If a loan made by a lender is therefore deemed to carry excess or onerous terms due to "redlining," it may actually be due to FNMA policies.

(4) Our analysis assumes that borrowers are aware of which lender charges the lower mortgage interest rate.

(5) Needless to say, usury ceilings and foreclosure laws further complicate the detection of redlining.

(6) That is, one must be able to determine whether to decline in V_B is due to an increase in i_B, holding N_B constant, or to a decline in N_B, holding i_B constant.

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LABOR VERSUS CAPITAL IN THE U.S. PUBLIC SECTOR

By William Paul Orzechowski

An important characteristic common to many countries has been the growing size and rising power of the public sector. Over the past century many nations have allocated an increasing amount of resources and decision making power to the public sector. A larger public sector is seen by many as a viable means for achieving important social and economic goals. While some may quarrel with the intent of these goals, there is increasing skepticism about the efficacy of the government in attaining these objectives. In particular, the seemingly world-wide experiment with big government has led to a greater awareness of bureaucracy or control of resources by public agency. The traditional approach to bureaucracy has been to assume that bureaus would mechanically implement their assigned tasks of social policy; however, recent theoretical developments in economics have explicitly analyzed the bureau within the context of behavior models.

In general, the economic approach to bureacracy assumes that bureaucrats attempt to maximize personal goals or utility within an environment that is inextricably dominated by both political and economic forces. The economic approach, then, does not view the bureaucrat as an automaton but as a conscious benefit-cost calculator. From this perspective, economists have argued that public agencies tend to operate in a highly political manner and are apt to choose policies designed primarily to maintain the growth and survival of the public agency. Consequently, this approach has repeatedly stressed the range and nature of bureaucratic choice. It suggests that public decision makers will use resources in a manner that is often constrained by political pressures and that a successful effort, in this regard, will simultaneously reward the bureaucrat with a pay-off in the form of considerable managerial discretion. The thrust of the analysis indicates that bureaus will operate in a notoriously inefficient manner relative to the private sector.(1) That is, they will tend to use resources in a "wasteful" manner or pursue strategies that result in an over-expansion of their activities.

One extremely important aspect of this economic approach

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has been an investigation of bureaucratic behavior in the choice of labor and capital inputs for production. Theorists have argued that distortions or perversities in the production process associated with bureaucracy may reflect itself in the manner by which bureaus utilize labor and capital inputs. It is hypothesized that bureaucrats are often in a position to expropriate vast sums of wealth from the services they produce but cannot do so in a direct manner since they are not permitted to take "profits" or surplus in monetary form. Instead, it is argued that expropriation will take the form of indirect pay-offs. Often, this may result in the over-utilization of labor and/or capital. For example, the early criticism of bureaucracy is often characterized by its reference to the "gold-plating" and over-staffing tendencies of public agencies.(2) In a similar manner economists have argued that bureau power may lead to labor and capital distortion. In some circumstances bureaucratic behavior may lead to a labor intensive production; in other cases, a bias in favor of capital may be present, even though *economic* conditions are the same.

This paper systematically relates labor and capital distortions: Using the U.S.A. as a case study, it is shown that documented labor and capital biases in American bureaucracy tend to fit an interesting and consistent pattern. This pattern is fundamentally caused by the existence of layers of governments in a society. That is a capital or labor bias is often associated with the level of government found within a country. In the U.S.A. these layers or levels of government are associated with the familiar local, state and federal distinctions. Since most other democratic nations have similar governmental structures, the analysis presented herein should have broad policy implications for other nations as well. The model provides an additional means by which to observe the discretionary and political influence on the use of the world's scarce resources by public decision makers.

In section two a summary of the development of the factors of production approach to bureacracy is presented; in sections three and four, a new model of bureaucratic labor and capital usage is constructed which emphasizes the importance of different layers of government and empirical evidence is presented. The fifth section outlines applications of the model to other sectors of the economy. The last section contains a summary

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and the conclusions.

II. The Choice of Labor and Capital in Bureaucracy

Theories concerning the choce of labor and capital inputs in the public sector have been developed by a number of scholars.(3) Most of these theories suggest that bureaus will have a tendency to prefer either labor or capital inputs in the production process. That is, they will tend to use capital-labor proportions that are inefficient compared to the private sector. For example, some of the earliest literature dealing with this aspect of bureaucracy suggested that bureaus would tend to over-staff.(4) It was hypothesized that a larger staff was essentially a means by which to expropriate a portion of the surplus wealth generated by a bureau. Higher salaries, upward mobility, and job security were all positively related to "empire-building" through the development of a larger staff. Parkinson and others documented these assertions by case studies which indicated a tremendous over-staffing problem in British bureaucracy.(5) Likewise other theorists have suggested that bureaus may have a tendancy to prefer capital relative to labor inputs. DeAlessi suggested that bureaus may favor capital intensive production methods because these types of programs tend to lump a larger portion of costs in a shorter time horizon.(6) Thus it is hypothesized that capital-intensive methods of production yield greater utility to budget-minded bureaucrats than labor-intensive methods which provide the same budget but over a longer time span.

The theories referred to above may be described as "preference" theories. The preference scheme essentially focuses upon the bureaucrat as the prime mover or the central actor in the production process. The methods used by the bureaucrat in order to expropriate some part of the budget of the agency and thus increase his own self-interest is of central concern. However, other theories concerning labor and capital usage within bureaucracy accent other parties that interact with the bureaucrat in the general context of the public decision making process. These theories, "pressure" theories, stress the ability of political lobbies to influence the hiring decisions of bureaucrats. These theories also indicate that bureaucrats may tend to favor capital or labor inputs because of the role played by outside

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parties. One important example of this approach is the "voter-effect." (7) Here it is argued that bureaucrats, in certain circumstances, may use a disproportionate amount of labor because each unit of labor represents a potential vote in favor of the agency's budget. Thus an effective way to ensure bureaucratic growth and survival is to, in effect, hire a voting constituency. Likewise lobbies may also influence bureaucrats in using disproportionate amounts of capital. This may occur on the part of manufacturers who supply public agencies with various kinds of capital equipment. At levels of government where the voter effect is diluted, capital suppliers may exert extreme pressure upon the bureau to favor its products.

The problem that emerges is one of identifying the circumstances that lead to the choice of a labor or a capital bias. Otherwise one is left with the proposition that bureaus may be both labor and capital voracious. Labor and capital choice by bureaus may lead to similar patterns exhibited by the private sector but for quite different reasons. In order to deal with this problem, a model is presented, in the next section, that resolves much of this confusion but, first, relevant empirical research on the subject is summarized.

Empirical research has taken two forms. There have been studies that compare capital to labor ratios, for a similar production process, of the public versus the private sector. Secondly, studies have compared capital to labor ratios by level of government for a particular production process within the public sector. The former studies suggest that the public sector uses factor proportions dissimilar to the private sector. The latter studies indicate that dissimilarity in factor proportions exists among public agencies producing similar services by level of government.

In one of the private and public sector comparisons, a strong labor bias was observed to exist in state and local and public colleges and universities relative to private institutions.(8) In another study, a strong capital bias was observed when a comparison was made of capital to labor ratios for the federal government and relevant private sectors.(9) Lastly, Cummings and Ruhter found a capital bias within the public sector as degree of public control passes from local to state and federal levels.(10)

From the discussion above, it appears that theory and evidence conflict. Theory predicts both a labor and a capital bias

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and empirical evidence tends to support both. If the factor intensity approach is useful, it should be able to predict the conditions under which a labor or capital bias will dominate in private/public comparisons. In order to resolve this inconsistency, an elementary model is developed which incorporates both the preference and pressure theories of factor intensity. Because the preference theories indicate both a labor and capital bias and no a priori assumption can be made as to which effect is stronger, and implicit assumption will be that preferences are neutral. This allows us to focus on the pressure theory of bureaucracy which can then be used as an aid in determining the circumstances that lead to either a labor or a capital bias. The method assumes that factor intensities in the private and public sectors are dependent upon the degree of centralization or the layers of government. For the public sector in the U.S., degree of centralization would be represented by the continuum of local, state, and federal control and, for the private sector, this would correspond to local, regional, and national markets.

Degree of centralization becomes an important unifying factor because of an hypothesized capital bias that occurs within the public sector: (11) As degree of control passes from local to federal levels, the political benefits and costs of pro-capital policies shift in a favorable direction. Bureaucrats may choose labor-based factor proportions at local levels of government because the benefits from this input would be large given that labor suppliers typically live and vote in areas where they are employed. At more centralized levels of government the pressure for pro-labor policies are lower and the pressure for pro-capital policies increase, because less labor pressure is exerted at the state level due to the lesser influence of the "worker-voter" effect and the greater political influence of national and regional capital suppliers. Capital suppliers prefer to lobby at centralized levels rather than lobbying through thousands of municipal governments.

The hypothesized capital and labor bias effects across sectors of the economy and within bureaucracy can now be unified by an elementary model. These elements are brought together with the aid of Figure I(a). On the vertical axis is the capital to labor ratio (X) for a particular production process. On the horizontal axis is the degree of centralized supply (C). (X) pvt prepresents the capital to labor ratio for the private sector. Because the pri-

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vate sector's goal is profit maximization, it has no particular preference for either labor or capital, so the capital to labor ratio does not vary by type of market served and the ratio is represented by a horizontal line. (X) public is the capital to labor ratio for the public sector which is drawn under the assumption of the rising capital bias effect suggested above and empirically estimated by Cummings and Ruhter. The model indicates that bureaucrats will more than likely choose either a labor or a capital-biased factor intensity relative to the private sector and that the bias will be systematically related to the degree of centralization. In general, a labor bias would be predicted to dominate at local levels and a capital bias at national or federal levels. Factor intensities in a private and public comparison should be most similar at a median level of centralization. Where this threshold exists is a matter of conjecture but would probably exist in state and regional markets.

The model can be used to re-interpret in empirical evidence in bureaucracy. Consider an empirical estimate of capital to labor ratios for the public and private sector. If this comparison consists of state and local institutions, we may find a labor bias in the public sector. This is because local and state institutions would maximize by operating on the line segment (AB). The less centralized institutions would cluster along the bottom portion of (AB) while the more centralized institutions would cluster along the top portion of this segment. Thus, in a state and local comparison of private and public sectors, a labor bias may exist in the public sector since mean (X) public may be dominated by institutions in the (OX) range, but coincidentally we would observe a strong capital bias within the public sector as degree of centralization increases from O to Y. These effects are corroborated by the higher education sample cited earlier where a strong labor bias was observed in the public sector in a comparison of state and local private and public institutions. The rising capital bias effect within the public sector has been documented by Cummings and Ruhter. Finally, if a comparison of capital to labor ratios were conducted isolating the federal sector and the private sector a strong capital bias may be observed in the public sector. The last observation would be consistent with the studies of capital intensities in the federal and private sectors.

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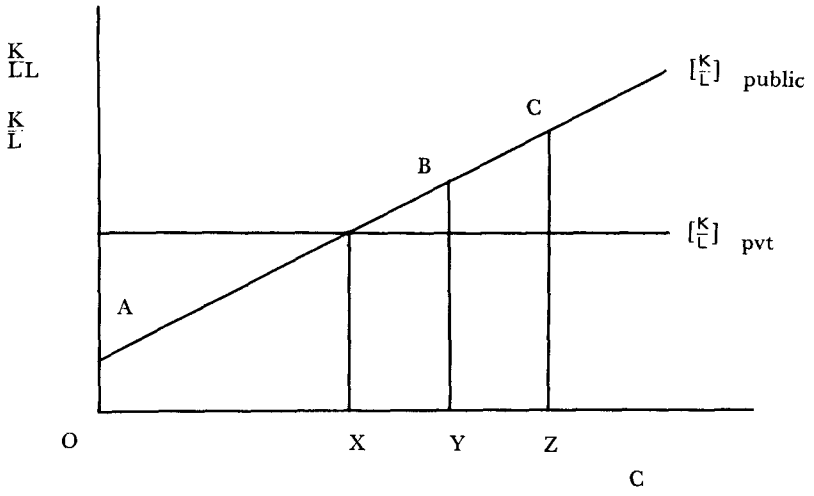
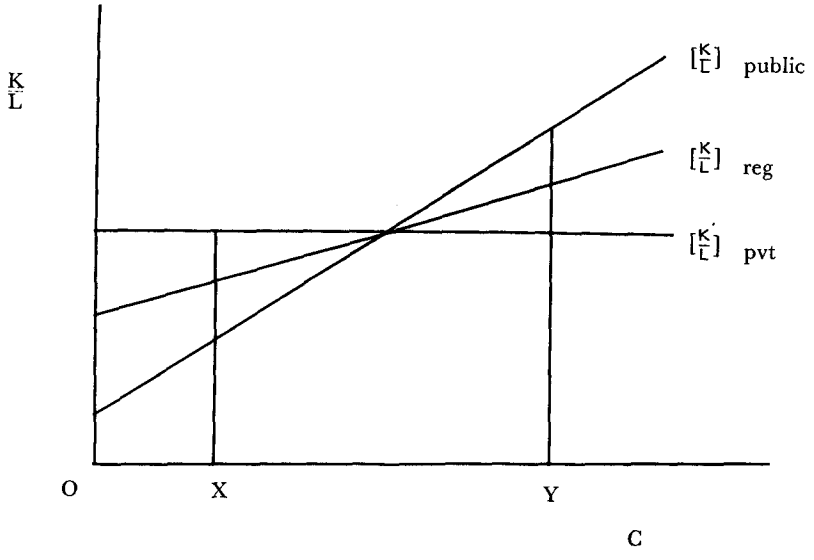
FIGURE 1



(a)



(b)

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IV Additional Evidence

At this point, it is of interest to present additional evidence on factor intensities comparing capital and labor ratios for the State of Virginia (Table 1). The mean capital to labor ratio for private colleges and universities was 3415, while the mean for the public sector was 1724. A definite labor bias is suggested in a private to public comparison but an interesting by-product is the documentation of the capital bias effect within the public sector. Low capital of labor ratios were found to exist at locally controlled public colleges and universities, whereas state controlled institutions exhibited a more capital intense profile. Curiously enough, the one institution in Virginia with the most probable federal influence, Virginia Military Institute, shows an extremely high capital to labor ratio (5679), in fact, much higher than the mean ratio for the private sector.

Lastly, in a study of capital to labor ratios within the federal sector (Table 2) rather extreme variation is observed among the various bureaus that make up the federal government. Variation occurs from a high capital to labor ratio of 1, 542, 057 for the AEC to a low 2, 751 for the Post Office. One must take extreme caution interpreting these estimates. For example, some of the agencies show high ratios simply because the capital estimates include financial items such as loans. Capital intensity for HUD, HEW, Agriculture, Interior, and the Treasury must be discounted for this factor. Nevertheless, the data provides impressionistic evidence for input biases in the bureaucratic production process. Capital suppliers, for example, may encounter extreme difficulty with an agency such as the Post Office where sizeable pools of labor are employed within many municipalities. Under these circumstances local politicians may maximize support by pursuing policies which protect postal employment. This may make Congress restrictive in regard to capital intensive innovation in this area. On the other hand, agencies characterized by production processes associated with minimal worker-voter influence may have a tendency to be "captured" by capital suppliers. For example, TVA, Transportation, AEC, Commerce engage in many construction projects. While many laborers are involved in such projects, employment is of a short duration and this may nullify worker-voter influence.

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TABLE 1

CAPITAL TO LABOR RATIOS (VIRGINIA)*

Public Sector (State Control)	2328
Public Sector (Local Control)	894.38
Private Sector	3415.1
Public Sector (Total)	1735

Source: *Inventory of Physical Facilities: Institutions of Higher Learning*, 1968. (Washington, D.C.: U.S. Government Printing Office, 1971); and National Center for Educational Statistics, *Employment Characteristics*: Institution of Higher Learning, 1968 (Washington, D.C.: U.S. Government Printing Office, 1971).

* eleven observations public state control
eight observations public local control
thirteen observations private control

TABLE 2

SELECTED CAPITAL RATIOS FOR FEDERAL AGENCIES

Agriculture	163,793
Commerce	75,850
HEW	28,440
HUD	873,333
Interior	119,567
Justice	17,500
Labor	8,000
Post Office	2,751
State	5,400
Transportation	57,272
Treasury	324,091
G.S.A.	255,263
AEC	1,542,857
V.A.	35,502
T.V.A.	177,272

Source: U.S. Statistical Abstract, 1975.

* Capital measurement was a composite of total real and personal property.

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V Other Applications of the Model

One can speculate on further extensions of the framework derived above. For example, comparisons could be made between public, regulated, and private sectors. Much of the regulatory literature, pioneered by Stigler(9) and refined by Peltzman,(10) suggests that regulated industries may act in a "political manner." Although most of this literature is concerned with the effects of regulation on price structures, profits, and entry rates, a potentially fruitful by-product of this analysis might be an inspection of politically-induced factor proprotions.

For example, Figure 1 (b) reproduces the original framework above with a hypothetical input preference function for a highly regulated industry (X) reg. Initially, it might be theorized that a similar capital bias effect may be formed in the regulated sector as in the public sector. That is, the same kind of factor supplier pressure may confront a regulator as it does bureaucratic decision makers; however, since a regulated industry would be expected to act in a more profit maximizing manner the shape of the preference function is drawn with a more gentle slope.

Many kinds of interesting comparisons could be devised using the scheme above. For example, suppose a comparison were made among types of utility companies by type of market served. If the companies served a broad geographical market then we may observe a point such as (X) in Figure I(b). We would expect the public sector to be most capital intensive, the private company to be least capital intensive and the regulated company in a median position. We may predict that the publicly controlled TVA would be more capital intensive than regulated or private counterparts serving the same kind of market. On the other hand, if we concentrated analysis at the local level, position (Y) in Figure I(b), we would expect the public sector to be most labor intensive, the private sector to be least intensive and the regulated company in a median position. Finally an interesting switching phenomenon may occur. Starting from a local market, we would expect regulated companies to be more labor intensive than private counterparts, but as the market became broader in scope, the regulated company would switch to a relatively higher capital profile.

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The "new" regulatory economics, in many cases, often describes the regulatory process simultaneously as a delicate redistributive process and a blunt redistributive weapon. Pricing is viewed as an intricate political mechanism whereby benefits and costs are distributed along consumer and producer groups in a carefully constrained manner. Yet "entry politics" is often characterized in blunt terms, for much emphasis is placed upon severe methods such as restrictive licensure, quotas and the like. Entry restriction may, in part, determine the size of the "political pie" (consumer surplus and potential profit), but once this is fixed competition among groups of producers and consumers may lead to a zero political rent equilibrium for many of the groups involved. An important part of this process may be the role of factor-suppliers. Research in this area will provide an interesting counterpart to the economic analysis of pricing and profits in regulated industries.(12)

VI Summary and Conclusions

An attempt has been made to develop a model of labor and capital choice in bureaucracy that embraces the standard political sub-divisions found within most democratic nations and even many totalitarian nations of the world. The layers or levels of government have been used to explain the pattern of labor and capital biases within the public sector. In this way the approach tends to unveil the political and discretionary influence in the use of society's scarce resources by public decision makers. While this analysis has been illustrated through a case study of U.S. bureaucracy, it should never-the-less have important relevance for bureaucracy in other nations as well.

FOOTNOTES

(1) Niskanen, William A. *Bureaucracy and Representative Government*. Chicago: Aldine - Atherton, 1971 and Migue, J.L. and Belanger, G. "Toward a General Theory of Managerial Discretion" *Public Choice* (Fall 1974).

(2) Parkinson, C. Northcote. *Parkinson's Law and other Studies in Administrations*. New York: Ballantine Books, 1957 and Von Mises, L. *Bureaucracy*. New Haven: Yale University Press, 1944.

(3) See, Williamson, Oliver E. *The Economics of Discreting Behavior: Managerial Objectives in a Theory of the Firm*. Englewood Cliffr: Prentice Hall, Inc. 1964

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and DeAless: Louis, "Implications of Property Rights for Government Investment Choices" *American Economic Review* (March 1969).

(4) Von Mises, L.; *Bureaucracy*. New Haven: Yale University Press, 1944.

(5) Parkinson; *op. cit.*

(6) DeAlessi; *op. cit.*

(7) Bush, Winston C. and Dezau, Arthur T. "The Voting Behavior of Bureaucrats and Public Sector Growth," in Borcherding, Thomas E. (ed.), *Budgets and Bureaucrats; The Sources of Government Growth,* Durham, North Carolina: Duke University Press, 1977.

(8) In this study an empirical analysis of capital to staff input ratios was performed on thirty-one states by control of institution (public versus private) for the year 1968. I regressed capital to labor ratios as a function of the relative price of capital by control of institution. The results indicated that public colleges in a state would be expected to employ roughly forty per cent more labor than private colleges for the same size capital stock. This result coupled with the fact that there appears to be little, if any, statistical difference in relative price ratios faced by public and private colleges, strongly buttresses the position that the labor bias estimated for public colleges is due to behavioral reasons associated with difference in ownership. See, William Orzechowski, "Economic Models of Bureaucracy: Survey, Extensions, and Evidence" in *Budgets and Bureaucrats*, Duke University Press, Durham, N.C., 1977.

(9) Orzechowski, William, "Labor Intensity, Productivity and the growth of the Federal Sector" *Public Choice* (Fall 1974) pp. 123-126.

(10) Cummings, F J. and Ruhter, Waye. "Some Tests of the Factor Supplier Pressure Group Hypothesis," *Public Choice* (Fall 1980).

(11) This effect is developed by Gordon Tullock, and can also be found in my doctoral dissertation. See, Tullock, Gordon "What is to be Done?" in Thomas E. Borcherding, ed; *Budgets and Bureaucrats*, Duke University Press, N.C. (1977). pp. 275-288.

(12) My own impression is that pricing is a more visible process than entry politics. That is, consumers are apt to have better information about pricing but entry often goes unnoticed. For example, it is very easy to convince people that restrictive entry is desirable on the basis of any sort of health, safety, and welfare argument. In a similar vein, political activity may find its most blatant expression in factor distortion since this process appears to be less visible than pricing.

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THE POLITICAL ECONOMY OF FEDERAL GOVERNMENT GROWTH: 1959-1978

by James T. Bennett and Manuel H. Johnson

How much has the federal government expanded in two decades? Why has this expansion been possible? For those interested in these questions, this important book is essential reading.

Bennett and Johnson begin with *facts* about the growth of federal government. Their studies reveal that the growth of government has changed its form. Blue-collar federal workers have been replaced by white-collar ones. Within the federal white-collar force, lower-grade workers have been replaced by individuals in policy-making grades. The size of the federal sector has been grossly understated because contractors, consultants, and part-time employees are not counted. Changes in government structure are exposed so that the reader can clearly recognize what has been occurring, unhindered, for twenty years.

The authors discuss popular theories on government growth and then provide their own explanation: it pays those in charge to expand their domain. General readers are provided a fine introduction to the realities of self interest in the land of public interest rhetoric.

Why do the constraints on government officials change? How can the expansion of the federal government be halted? Bennett and Johnson suggest a new arrangement of incentives for politicians and bureaucrats.

October, 1980

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